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Brazilian Minister Steps Down After Corruption Charges

by LADB Staff

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Brazilian Finance Minister Antonio Palocci stepped down from his post on March 27 after an investigation into corruption allegations against him made his life "hell," in his words. Guido Mantega, president of the Banco Nacional do Desenvolvimento Economico e Social (BNDES), took over the position of finance minister. Investors view the position as the most important ministerial post and had seen Palocci as their "guarantee" of fiscal stability in the Brazilian government, so Brazilian markets and the value of the national currency, the real, dove in the days following news of his resignation. President Luiz Inacio Lula da Silva may also face political consequences from the incident.

Palocci implicated in misuse of bank records

Palocci, commonly known as the architect of Brazil's economic recovery and market-friendly fiscal policy, sent a resignation letter on March 27 to President Lula, who accepted the resignation. Palocci faces accusations that he frequented a house in Brasilia where lobbyists held parties with prostitutes and money arrived by the suitcase, possibly for political payoffs. He denies the accusations.

The scandal was low profile until the week before his resignation, when bank records from the caretaker who placed Palocci at the house were leaked from the state-owned Caixa Economica Federal (CEF).

A key allegation against Palocci was that he violated banking-secrecy laws by making public the bank's records of house caretaker Francenildo dos Santos Costa to discredit him as a witness against the finance minister. Santos Costa had previously testified that he had seen Palocci "at least ten times" at the house. There had been speculation that Palocci's supporters leaked the records in the hope of showing Santos Costa was paid for his testimony. The records showed recent deposits of US \$11,400, but the caretaker, who was born out of wedlock, said the money came from his biological father, who was trying to avert a paternity suit.

CEF President Jorge Mattoso told police on March 27 that he personally handed the bank records over to Palocci, whose ministry oversees the bank. Police charged Mattoso with violating bank-secrecy laws, the government's official news agency Agencia Brasil reported. Palocci denies ever being in the house, but analysts and opposition-party leaders said he would be forced to resign if he were linked to the release of the bank records.

The week before, Palocci said his policies to contain inflation and reduce the budget deficit would remain in place even if he resigned because of political pressure from opponents. "Brazil's economy has nothing but clear skies ahead, even though the finance minister is going through hell," Palocci told executives in Sao Paulo on March 24. The Partido da Social Democracia Brasileira (PSDB) on March 23 proposed Palocci's impeachment to lower-house president Aldo Rebelo. The party accused Palocci of committing perjury during his testimony before a congressional committee probing corruption.

Allegations against Palocci had been lingering for several months. Attorney Rogerio Buratti a former Palocci advisor from his days as city prefect, or mayor, in Ribeirao Preto, Sao Paulo was imprisoned for money laundering and forming a gang to carry out criminal schemes in Ribeirao Preto. In August 2005, Buratti accused Palocci of receiving 50,000 reais (about US\$23,000) per month from city contractors between 2001 and 2002, during his term as prefect.

Further allegations that Lula's presidential campaign received US\$3 million in unreported campaign cash flown into Brazil from Cuba in cases disguised as drink crates cast suspicions on Palocci. Justice Minister Marcio Thomaz Bastos on April 3 that Brazilian police were nearing the end of their probe into allegations that Palocci broke bank-secrecy laws in an attempt to discredit Santos Costa.

"The investigation is 80% complete," Bastos said. "I have given the police full rein to investigate this case." A federal-police spokesperson in Brasilia said any decision on charging Palocci would come only after he testified on April 5. Bastos also said allegations that Justice Ministry officials knew of Palocci's actions and failed to report them were false. After Palocci left office, many under him followed.

Executive secretary Murilo Portugal, the effective vice minister of finance, resigned. Joaquim Levy, secretary of the National Treasury, followed Portugal and moved on to take a vice presidential post in the Inter-American Development Bank (IDB). Adjunct treasury secretary Jose Antonio Gragnani said he would be heading for the Massachusetts Institute of Technology (MIT) to study management. They were the government's top debt officials.

Cash-for-votes investigation ends, goes to prosecutors

Two days after Palocci's resignation, the 10-month parliamentary investigation (Commissao Parlamentar de Inquerito, CPI) into accusations that the various federal deputies received monthly bribes to vote for Partido dos Trabalhadores (PT) legislation and that the PT maintained an illegal, unreported campaign treasury during Lula's presidential run in 2002 came to a close. The CPI published its 1,800-page report and readied it for delivery to federal prosecutors.

The report called for the prosecution of more than 100 people, including federal deputies and two former government ministers, but cleared Lula of criminal wrongdoing. The investigation uncovered

evidence that the governing PT made illegal cash payments to lawmakers from other parties that joined its coalition.

The "mensalao," or monthly-payments scandal, occurred when PT officials supposedly directed monthly under-the-counter payments to swing voters to pass the PT's legislative projects. The inquiry was originally set up to look into allegations of corruption in Brazil's state-run postal service, focusing on Deputy Roberto Jefferson. Jefferson soon informed investigators about what he alleged was a widespread scheme to buy votes from parliamentary allies with undeclared cash deliveries, bringing down many legislators and top PT figures with him ([NotiSur, June 24, 2005](#), [Sept. 9, 2005](#), and [Dec. 9, 2005](#)).

The report named 19 sitting or former deputies, three former PT executives, and two government ministers who resigned last year over the allegations. On the specific bribery allegations, the report concludes that the PT did move millions of dollars in undeclared funds to its allies, breaking Brazilian electoral law. It says the president was warned about the scheme but it clears him of any cover-up, pointing out that he had asked Political Coordination Minister Aldo Rebelo to investigate the corruption claims. The report's author, Deputy Osmar Serraglio, suggested indicting the 100-plus individuals, including former chief of staff Jose Dirceu, former PT treasurer Delubio Soares, and advertising executive Marcos Valerio Fernandes de Souza for coordinating the bribery scheme.

"We have strong proof that the bribery scheme happened; it's not something in our imagination," Serraglio said to journalists in Brasilia. "We'll send the report to the prosecutors' office after it's approved, and they will determine whether our evidence is consistent." Serraglio submitted the report March 29 for approval by the committee, which planned to vote on it the following week, he said. Assuming it's approved, the report would be sent to the prosecutor's office for further investigation.

Lula said in earlier interviews that his party never paid bribes to legislators. Lula had overcome a slump in poll numbers that resulted from public disillusionment with the PT's alleged involvement in various illegal fiscal schemes (see [NotiSur, 2006-03-24](#)), but it has yet to become clear whether Palocci's resignation or future prosecutorial actions will reverse Lula's rise in voter support.

Palocci's fall is the latest blow that corruption investigations have dealt to Lula's Cabinet. In 2005, his former chief of staff and top advisor Dirceu was impeached and banned from public office for eight years. Many PT deputies, along with a smaller number of deputies from other parties, have been removed from office and are under investigation by the Public Ministry, the federal government's prosecutorial arm.

New minister Mantega says fiscal policies will not change

Mantega's appearance in the Finance Ministry reignited always-smoldering investor angst that Lula would start applying economic policies similar to those he promised while campaigning for president, leading to drops in Brazil's various markets. But, by March 31, a rebound appeared underway after Mantega exhibited fiscally conservative tendencies similar to Palocci's. The 57-year-old Mantega was a minister for planning, budget and administration until the end of 2004, when Lula named him as head of BNDES, the state-owned development bank. During the 2002 presidential campaign, he was a top Lula advisor.

Mantega sought to contain any damage on the markets by promising economic stability and to stay the course on Brazil's monetary policy aimed at paying down debt and reining in inflation. Palocci's time in office saw raised interest rates, inflation reduced to a single digit, and a strengthened real. As Lula's social reforms bogged down, Palocci became a symbol of stability for foreign investors, who poured money into Brazil. Mantega spoke to reassure investors on March 28 by saying he would not relax Palocci's tight restrictions on public spending. "I'm not a spender," Mantega said in a televised interview.

Under Palocci's policy to reverse boom-and-bust economic cycles and spark slow sustainable growth, "Brazil has become a country that is respected abroad," Mantega said. That pledge did little to ease jittery investors concerned that Mantega might reduce interest rates too quickly to keep inflation, currently at 5.5%, in check, or give Lula support for more populist economic policies to satisfy his leftist base.

Mantega has been a strong critic of Brazil's high interest rates, causing concern among some nervous market watchers afraid of excessive economic growth in Brazil and resultant inflation or instability. On March 31, Mantega cut the BNDES bank's lending rate to a record low in an effort to bolster growth. The three-member Conselho Monetario Nacional (CMN), headed by Mantega, voted unanimously to lower the bank's long-term lending rate 0.85 percentage point to 8.15%.

"It wasn't too aggressive a move by them, and it will avert sending signals that policy will change," said Adauto Lima, chief economist at the Brazilian unit of WestLB AG. The CMN, which sets the BNDES rate quarterly, had lowered the rate 0.75 percentage point in December after the central bank cut its benchmark overnight lending rate four times. Since that December cut, the central bank has reduced its rate twice more, lowering it 1.5 percentage points to 16.5%.

The day after Mantega's appointment, the Bolsa de Valores do Estado de Sao Paulo (Bovespa) dropped 2.54% and the dollar was up against the real 1.75% in the second day of declines. But by March 31 traders appeared to gain confidence in Mantega, with indicators back on the rise after the minister made new appointments like naming 37-year-old Carlos Kawall to head government debt sales as treasury secretary.

Lula shuffles Cabinet, 8 ex-members to run for office

On March 31, Lula replaced his congressional liaison, Jacques Wagner, and seven other ministers who were stepping down to run for office in the October elections. Tarso Genro, a former education minister and PT president, replaced Wagner as Institutional Affairs Minister as Wagner and the others left to meet a deadline for filing as candidates. Lula also named as Defense Minister Waldir Pires to take the place of Vice President Jose Alencar. "I'll be working hard to preserve political stability this year, which is the toughest period for every government," Genro said in an interview in Brasilia. "The electoral period is always very tense and radical." Lula will rely on Genro and Chief of Staff Dilma Rousseff to help keep his coalition united through votes on this year's budget and congressional probes of alleged government corruption, said political analyst David Fleischer.

Still, a Cabinet shuffle in an election year, when Congress can be expected to shoulder a lighter workload, leaves Lula less dependent on ministers to mobilize lawmakers, Fleischer said. "The country will now focus on elections and Congress will cool down," said Fleischer, a political science professor at the Universidade de Brasilia. "The replacements are natural and don't create any concerns."

The ministerial reshuffle occurs in the last year of every administration as ministers must resign their posts before March 31 to qualify to run for office in October's elections. Brazil holds national elections for president, state governors, senators, and lower-house deputies on Oct. 1.

Lula has not yet announced whether he will be running for re-election. Other Cabinet members leaving are: National Integration Minister Ciro Gomes; Defense Minister Jose Alencar; Health Minister Saraiva Felipe; Transportation Minister Alfredo Nascimento; Fishing and Agricultural Minister Jose Wilson Fritsch; Agrarian Development Minister Miguel Rosseto; and Sports and Tourism Minister Agnaldo Queiroz. Orlando Silva Jr. was appointed sports and tourism minister, Paulo Sergio de Oliveira Passos is the new transportation minister, Pedro Brito Nascimento will be integration minister, and Waldir Pires becomes defense minister, said presidential spokesperson Andre Singer at a press conference in Brasilia.

Lula also named four others who will replace four ministers temporarily, Singer said. They are Altemir Gregolin as fishing and agricultural minister, Guilherme Cassel as agrarian development minister, Jose Agenor Alvares da Silva as health minister, and Jorge Haage in the federal government's controlling office.

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