The Effect of Corruption on Brazil's Economy

Ty Woodruff

Eastern Michigan University

Abstract

This report examines the effects of corruption on a country's ability to progress as a global economic power, and the implications of such effects on the country of Brazil. Already the largest economy in South America, Brazil has recently emerged as a major player in the global economy. However, the country has had a long standing battle with corruption throughout its history, an issue that threatens to derail its economic potential. How corruption affects a country's economic progress as well as the sources of corruption in Brazil and possible solutions in combating it conclude the main discussion and analysis of the paper.

Keywords: Brazil, corruption, economy

Introduction

Increasing economic power and international recognition are not without risks, as the country of Brazil is well aware of. As a country projected to experience an increase of economic growth in both private sector business and in public trade, it also stands to lose a lot more if it does not eliminate the formidable obstacle in its way of vast economic growth – corruption. By examining the literature available on the causes and effects of corruption on a country's economy along with Brazil's historical relationship with corruption, and through careful analysis, the intention of this paper is to answer the question of what causes corruption in Brazil and how it can be eliminated in order to fulfill its economic potential.

To truly understand the massive implications of corruption in a growing economy such as Brazil, one must understand how far the country has come economically in recent years. As the world's fifth largest country, both in population and in geographical area, Brazil is quickly becoming a major economic player on a global level. Brazil boasts the seventh largest economy in the world by gross domestic product (GDP), the eighth largest economy in the world by purchasing power parity, and the largest economy overall on the continent of South America (Business Anti-Corruption Portal, 2011). Major economic reforms have allowed staggering growth in addition to new international recognition, with major developments in agriculture, mining, manufacturing, and service sectors. Since 2003, Brazil has improved its macroeconomic stability; it has built foreign reserves, reduced its debt, kept inflation rates under control, and showed commitment to fiscal responsibilities (Universia Wharton, 2010).

After experiencing unprecedented economic growth in 2007 and 2008, the global financial crisis finally began to affect Brazil's economy. Currency and stock markets showed large fluctuations as foreign investments began to shrink, demand for commodity exports decreased, and external credit increased. Recently, however, Brazil was back in the international spotlight as it became one of the first emerging markets to stage an economic recovery, with positive growth in GDP purchasing power parity, jumping from $2.021 trillion in 2009 to $2.172 trillion in 2010 (CIA, 2011).

This is in part due to its openness to and encouragement of foreign investments, solidifying its place as one of the world's leading investment destinations. The Brazilian government is a proponent of both state participation as well as respecting the contractual rights of investors (Business Anti-Corruption Portal, 2011). It has also been a leading player on the global trade scene, as a member of numerous economic organizations such as G-20 and the Cairns Group. Brazil boasts hundreds of trading partners, with $387.4 billion in total trade volume in 2010 (Economy Watch, 2011).

As companies in Brazil desire to compete at a global scale, and the government focuses its sights on increasing its global trade partnerships, curbing corruption has to become a top priority. Local firms are finding changes are essential in order to work with international companies, which are bound by foreign anti-bribery laws (Stewart, 2010). Over the years, the country has taken measures to develop a strong legal framework aimed at curbing corruption, with formally strong and well-developed anti-corruption initiatives (Business Anti-Corruption Portal, 2011).

Literature Review

The size of Brazil's economy, the largest in South America, has increasingly made them a subject of interest to researchers. As an emerging economy in the midst of a worldwide recession, Brazil offers a unique outlook on economic growth. On the other hand, the country also has the dubious distinction of being perceived as one of the most corrupt in the world. The literature highlighting the role corruption has played and continues to play in Brazil is abundant; the same can also be said for the amount of literature stressing the effects of corruption on a country's ability to secure foreign investments and expand its trade relationships. Based on the available research concerning the two topics, it is possible to make valid assumptions concerning the implications Brazil's well-documented history of corruption may have in regards to its future economic growth.

Much of the corruption that takes place in Brazil can often be attributed to government officials abusing their power, leading many to view the country as an example of economic and political corruption over the last few decades. By the early 1970's, the Brazilian government believed that strong government interventions would benefit numerous areas of the economy. By the early 1990's, after two different oil shocks, a long foreign debt crisis, huge fiscal imbalance problems, GDP stagnation, and high inflation, the governmental policy had changed to privatization, trade stabilization, and deregulation (Werneck, 1996). These changes led to increased incidences of corruption among government officials, as the economic troubles the country had been experiencing created a chance to supplement earned income with bribes and other improprieties.

Taylor and Buranelli (2007) point out that corruption has also been a major problem during each of the post-democratic presidencies. One serious side effect of corruption scandals has been the decrease in effectiveness of political policy making, which eventually stalls reform agenda. This can be especially detrimental during times of tariff or tax reforms, or when there is an increase of foreign investments in the country.

Corruption in Brazil has not been limited to just top governmental figures; according to Ferraz and Finan (2008), local government corruption was so prevalent that voters on average shared the initial belief that most politicians are corrupt in general, and punishment was only necessary when incumbents had surpassed an appropriate level of corruption. In 2003, the Brazilian federal government began to select municipalities at random to audit their expenditures of federally transferred funds. These audits were the reason that, in 2006, eight former mayors were incarcerated for a variety of crimes, including malfeasance, extreme irregularities in bid procurement, over-invoicing, and forgery of payments to entities that did not exist, as Pereira et al. (2009) explain.

In general, government intervention in the economy has been shown to create numerous opportunities for corruption. Regulations require enforcement, and those chosen to enforce may face others who wish to circumvent such regulations, especially in emerging economies. Restrictions on the trade of certain goods is one such situation that can produce such an opportunity, where an importing or exporting party might bribe officials overseeing a certain restriction that could affect their business adversely. An example of this is bribing an official in order to acquire an import license for a good that may otherwise be unavailable due to a license restriction, or protecting a home industry by bribing influential officials to maintain a tariff at a level that discourages foreign competition. The use of multiple exchange rates is another practice that can create an opportunity for corruption; for instance, some countries have different exchange rates for importers and investors, which can lead to one choosing the rate that is most advantageous for their particular situation, regardless of its actual intended use (Mauro, 1997).

As one can see, multiple sources illustrate how corruption within a country's government can have a serious affect on its economic progress. It is also important to examine the incidence of corruption in the private sector of the economy, but the available literature tends to focus on the corruption of public officials, as they are often elected into their positions with the intention of serving the interests of the public as opposed to their own, and the stories are often sensationalized in the media (Ferraz and Finan, 2008). One interesting observation regarding the private sector, nonetheless, is the privatization of a number of Brazil's largest government run companies in the early 1990s. This was extremely beneficial to the country, as the operating efficiency of these companies increased, along with the reliability of public goods such as power and highways. Another reported benefit was a decrease in the level of corruption amongst public officials according to government watchdog groups (Latin Finance, 2001). However, as these groups focused their attention on monitoring corruption in the government, the question remains as to whether the incidence of corruption had actually decreased as a result of the shift to the private sector, or if it was just now going unreported. Recent studies have shown that private sector companies in Brazil do employ bribery as part of their routine business practice, especially when trying to gain a competitive advantage in foreign markets (Transparency International, 2009).

In order to combat this issue, Mele et al. (2006) proposed that companies develop a system of self-assessment to ensure business practices met ethical standards, including assessments of accounting, auditing and reporting policies, standardized procedures for dealing with ethical violations, and ethics-based training programs for managers and employees. The authors noted that research in business ethics and the use of ethics programs and offices are heavily underutilized in Brazil's private sector.

In an attempt to reduce the incidence of corruption and improve their global perception, Brazil, along with Argentina, Chile, Bulgaria, Slovakia, and the Organization for Economic

Cooperation and Development (OECD) signed the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, also known as "The Convention". The agreement, effective December 17, 1999, aimed to help strengthen a growing international movement to eliminate foreign corrupt practices that can amount to non-tariff barriers (Dattu et al., 2000). These signatories were required to criminalize acts of corruption, which are defined as the solicitation or acceptance of a bribe, the offering or granting of a bribe, improper acts or omissions by government officials, fraudulent acts or concealment of property, and conspiracy (Zagaris, Ohri, 1999). However, it has been found that top business executives at private firms in these countries still have little awareness of "The Convention", and that governments must commit to prevent the instance of bribery as a business tool, and prosecute those who employ such practices (Transparency International, 2009).

To see the effect corruption can have on a country's economic progress, one does not need to look any further than the situation Russia is currently facing. According to Franklin (2010), corruption alone costs the country $10 billion per year, causing its economy a myriad of disservices impeding economic growth and diversification. These range from increasing taxes on investments, decreasing infrastructure quality, and diverting human capital. Corruption in Russia has also slowed structural reform and increased transaction costs, which has proven to be a large factor in stifling the development of efficient markets (Franklin, 2010).

These are serious ramifications for a country like Brazil, which has been steadily working to make strides in its economy. This includes overcoming periods of rampant inflation to finally cull it to 4.4%, and boasting a per-capita GDP of $10,350 along with a projected GDP growth in 2011 of 4.5% (Economist, 2011).

Previous research has shown time and time again that corruption is detrimental to a growing economy, and Brazil is all too familiar with the subject. Corruption is a problem that the country must eradicate, or else risk unraveling the economic achievements in its recent years.

Analysis

The numbers do not lie: Brazil is an emerging economic power with the potential for significant growth on a global scale. In 2010, consumer and investor confidence returned as Brazil began its recovery after two quarters of recession, largely due to a burst in exports that year, from $153 billion in 2009 to $201.9 billion in 2010. Strong growth combined with high interest rates have attracted foreign investors over the past year, and the large capital inflows have contributed to a rapid appreciation of the country's currency (CIA, 2011). As we have seen from the research, however, corruption is still an issue that poses a serious threat to its success.

At the root of this threat is the Brazil's affinity for heavy economic regulation. Right alongside the growth in its economy is the growth of its government involvement. Some claim that this high level of involvement has been the cornerstone for Brazil's economic success, but on the microeconomic scale, it is a hindrance to freedom in business and has created the multitude of opportunities for corruption. For instance, high taxes and inefficient business regulations serve as entrepreneurial barriers in the country. Trade freedom is still impeded by various non-tariff barriers, such as restrictive regulatory and licensing rules, border taxes and fees, and complex customs procedures. Bureaucracy, administrations, and the judicial system are complicated and burdensome (The Heritage Foundation, 2011). All of these issues ultimately lead right back to the perpetuation of the same concern – the vulnerability of Brazil's regulatory system to corruption.

With these considerations, it is no surprise that Brazil has a long history of highly involved governments that have been riddled with corruption. In recent years, Brazil has faced multiple corruption scandals as politicians and bureaucrats have been found taking bribes in exchange for awarding public contracts to competing firms. Corruption exists in all political and business levels in Brazil, but is increasingly becoming a problem in dealings with the government at local levels. This is largely due to the nature of Brazil's federal structure, as companies in Brazil deal with a wide range of regulatory agencies in the course of conducting business activities, thereby increasing the likelihood of demands for bribes by public officials. Another structural issue is the complexity of the Brazilian tax system, leaving companies susceptible to tax collectors requesting bribes in exchange for relaxing tax assessments and inspections, or refraining from pursuing acts of tax fraud (Business Anti-Corruption Portal, 2011).

Corruption costs Brazil almost $41 billion a year alone, with 69.9% of the country's firms identifying the issue as a major constraint in successfully penetrating the global market (Stewart, 2010). In addition to the perception at a national level, numerous studies show that corruption and bribery are serious impediments for firms interested in doing business in Brazil, despite a formal and well-functioning economic environment. In 2011, Transparency International's Corruption Perceptions Index ranked Brazil 69th out of 178 countries, listed in order of the global market's perception of the level of corruption within each country's government. As illustrated in Figure 1, Brazil has shown improvement in its ranking over the recent years; however, one can see it has a long way to go. Brazil still lags far behind fellow South American country Chile, who ranks significantly higher at a level comparable with the United States, and just below Finland, who continuously tops the list each year as the least corrupt country in the world.

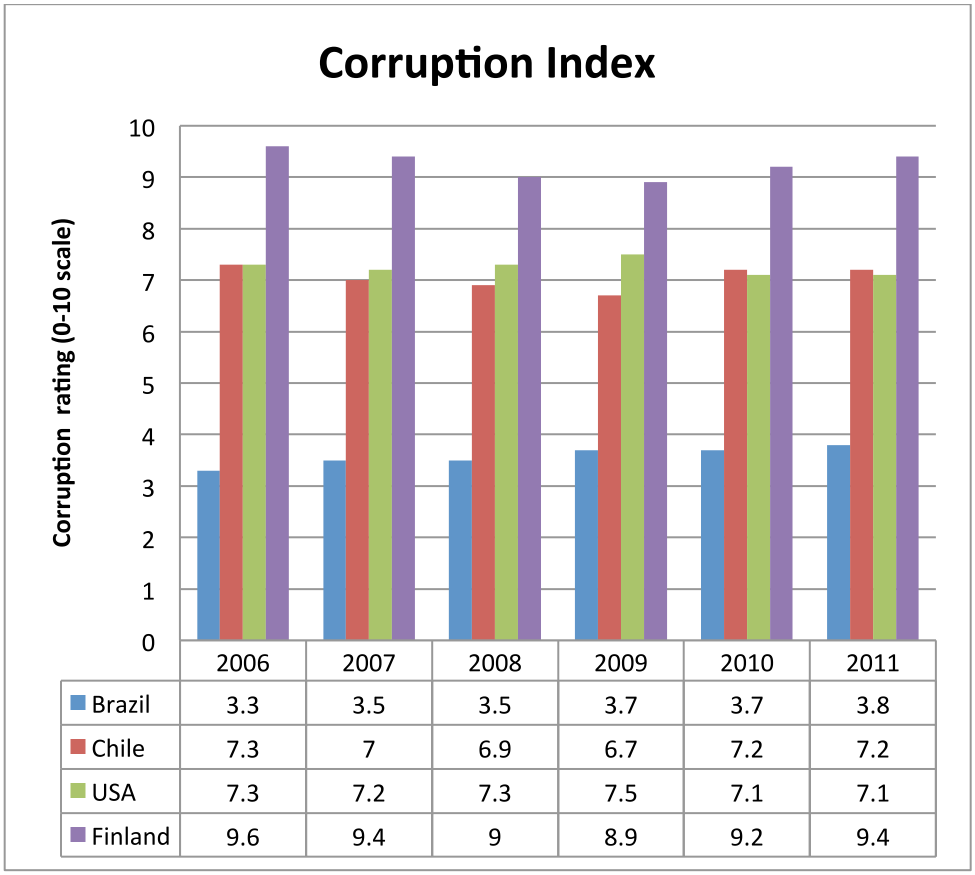

Figure 1 – Brazil's Corruption Rating on a scale from 0 to 10, with 0 being the most corrupt and 10 being the least corrupt, as compared to Chile, the United States, and Finland from 2006 to 2007 (Transparency International).

Transparency International also ranked Brazil 17th out of 22 leading exporting countries by their tendency of their private sector firms to employ bribery tactics when doing business abroad. This score indicates that despite the awareness of the damage corruption may have on corporate reputations and their communities, Brazil's firms are still using bribery to win business abroad. The majority of these corrupt transactions occur as a result of dealing with public sector policies, decisions, and practices – yet another example of corruption brought about by heavy government regulation.

Conclusion

After examining the literature regarding Brazil’s history of corruption and the cause and effect of corruption on a country in general, one can see the obvious correlation between the two topics. Governments that are heavily involved in economic regulation create restrictions and limit market freedoms that lead to the creation of opportunities for public officials to use their positions for the benefit of their personal interests, and the creation of opportunities for private firms to use resources in illegal and unethical ways to gain an advantage over their competition.

Brazil is a perfect example of a country with a high level of economic regulation and government involvement; it has multiple agency levels with a large number of officials in charge of enforcing a multitude of economic policies and restrictions. It also has a political and judicial system that has been shown throughout history to be vulnerable to corruption. Various scandals involving the bribery of public officials from local government levels all the way through high level public officials have been documented just as much as the growth of its economy.

It can be concluded from the research that increased regulation of foreign trade and investments is the source of the problem, much less the solution to it. Brazil’s historical pattern of corruption has been forged through its reliance on heavy regulation and multiple levels of government agencies. In order for Brazil to continue its economic growth and become a prominent international economic player, it has to attack and eradicate corruption from the ground up – removing the problem across all levels of government by reshaping its bureaucratic structure and implementing economic deregulation, thereby removing the opportunities for individuals to exploit their governing positions to benefit them illegally.

The research presented on the cause and effects of corruption in countries as well as a review of Brazil’s history and propensity for economic corruption is vast and well documented; however, the connection between its agency structures and reliance on heavy regulatory practices must be examined in more depth. This is especially important when seeking effective solutions to curb corruption.

To address this issue, in-depth research on the government practices and economic policies of countries that score low on the Corruption Perceptions Index should be conducted. The anti-corruption initiatives within these countries and their effects on curbing illegal activities should also be examined in detail. A comparison of Brazil’s government practices and economic policies, as well as the structure and results of its anti-corruption initiatives should be made to these countries. Analysis of the differences between Brazil and the respective countries would prove to be useful in formulating a solution to the corruption issue Brazil is facing.

References

Business Anti-Corruption Portal. (2011 June). *Brazil Country Profile*. Retrieved 2011 from http://www.business-anti-corruption.com/country-profiles/latin-america-the-caribbean/brazil/?pageid=238

CIA. (2011 October). *Brazil: World Factbook*. Retrieved from https://www.cia.gov/library/publications/the-world-factbook/geos/br.html

Dattu, R., Boscariol, J. W., & Goh, T.-y. (2008). A Proactive Step Against Bribery and Corruption. *International Trade*, 72-75.

Economy Watch. (2010 15-March). *Brazil Exports, Imports, and Trade*. Retrieved from http://www.economywatch.com/world_economy/brazil/export-import.html

Ferraz, C., & Finan, F. (2008). Exposing Corrupt Politicians: The Effects of Brazil's Publicly Released Audits on Electoral Outcomes. *Quarterly Journal of Economics*, 703-745.

Franklin, A. (2010). Targeted Tariff Preferences to Reduce Corruption in Developing States. *Georgetown Journal of International Law*, 1012-1041.

Heritage Foundation. (2011). *Freedom from Corruption*. Retrieved from http://www.heritage.org/index/Freedom-from-Corruption

Latin Finance. (2001). Coping with 'O Custo Brasil'. *Latin Finance*, 21-22.

Mele, D., Debeljuh, P., & Arruda, M. C. (2006). Corporate Ethical Policies in Large Corporations in Argentina, Brazil, and Spain. *Journal of Business Ethics*, 21-38.

Pereira, C., Melo, M. A., & Figueiredo, C. M. (2009). The Corruption-Enhancing Role of Re-Election Incentives? Counterintuitive Evidence from Brazil's Audit Reports. *Political Research Quarterly*, 731-744.

Peres-O'Brien, J. (2001). The Uphill Struggle of Brazil's Reforms. *Contemporary Review*, 92-99.

Stewart, A. (2010 5-October). *Brazil: Corruption Costs $41 Billion*. Retrieved from http://www.latinbusinesschronicle.com/app/article.aspx?id=4550

Taylor, M., & Buranelli, V. C. (2007). Ending Up in Pizza: Accountability as a Problem of Institutional Arrangement in Brazil. *Latin American Politics and Society*, 59-87.

The Economist. (2011 March). The World in Figures. *The World in 2011*, p. 121.

Transparency International. (2011). *Corruption Perceptions Index 2010*. Retrieved from http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results

Universia Wharton. (2010 1-March). *Lessons from Brazil: Why Is It Bouncing Back While Other Markets Stumble?* Retrieved from http://www.wharton.universia.net/index.cfm?fa=viewArticle&id=1807&language=english

Werneck, R. L. (1996). The changing role of the state in Brazil . *Quarterly Review of Economics and Finance*, 153-155.

Zagaris, B., & Ohri, S. L. (1999). The Emergence of an International Enforcement Regime of Transnational Corruption in the Americas. *Law and Policy in International Business*, 53-99.