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**Brazil: Judicial Institutions at a Crossroads****[Economic Reform Today](#) Brazil: Judicial Institutions at a Crossroads**

by Luiz Guilherme Migliora

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No one would disagree that a strong, effective judicial system underpins successful democratic government. It is also crucial to business growth in market-oriented economic systems. In order for business to prosper, contracts need to be honored, property rights must be respected and a stable business environment-socially as well as economically and politically-needs to be maintained. In many new democracies, the lion's share of attention goes to how to structure the executive and legislative branches, but the impact of the judicial branch on business and democracy cannot be overstated.

Brazil offers a good example of how the judicial system is failing to support business and coming dangerously close to undermining democracy. Legal disputes, which have increased dramatically, drag on for years without resolution, raising costs for businesses and increasing uncertainty for investors. Instead of solving problems, the legal system prolongs them. The criminal justice system, meanwhile, is bogged down, and criminals-both white-collar and violent offenders-have little fear of effective punishment. Criminality is rampant, and police-backed death squads roam the streets of Brazil's major cities, calling into question the extent of civilian control over this vital institution.

On the broader measure of how the judicial system affects the economy and facilitates economic reforms, Brazil also comes up short. The Western Hemisphere's second most populous nation, Brazil has long been a lodestar for foreign investment in Latin America, offering a large market and a wealth of natural resources. However, the legacy of a military dictatorship, which ruled Brazil from 1964 until the mid-1980s, has resulted in the weakening of the most important democratic institutions, especially the Congress and the political parties. In addition, the legacy of nationalistic, statist economic policies adopted during the dictatorship continues to undermine economic stability. Now, Brazil has begun to move in the right direction, gradually opening up its economy to competition and market forces, but must do more to restore its star to its original luster. Broader reforms-such as of the political system and the constitution-are currently being debated.

Today, events suggest that Brazil faces an institutional crossroads that could turn the judicial system around. Both the executive and legislative branches have been rocked by recent, well-publicized political corruption scandals implicating some of the country's highest officials, including President Fernando Collor, who was forced to resign last year, as well as cabinet ministers and congressional leaders. The ability of the news media to unearth these scandals and the public's reaction of disgust attest to a new climate of intolerance with the corrupt, "business as usual" politics of the past. The fact that politicians will now be held to a higher standard points to a deepening of democratic culture in the country despite its many problems. If Brazil's judicial structure can be modified to address these problems more effectively, democracy will have a much better chance at surviving over the long term.

**The Courts' Management Crisis**

Despite structural improvements effected under the 1988 Constitution, the judicial system is undergoing one of its most serious crises ever. The courts are extremely slow and fail to provide the parties to a lawsuit with expeditious solutions. The slowness results from the significant increase in the number of cases filed during the last five years, especially in the federal and labor courts, and from poor management. The problem has little to do with the structure of the system, which is actually fairly modern, or its procedural rules, which are adequate. In short, the system does not need extensive restructuring, but it does need major improvements.

One constitutional change has contributed to the big increase in court cases over the last five years. The new constitution contains mechanisms-like the collective writ of mandamus and the ação direta de inconstitucionalidade (a lawsuit to declare a law unconstitutional)-that enable unofficial institutions (e.g., associations, labor unions) to contest the actions of the executive branch, Congress and other official entities. This provision, designed to restore citizens' right to petition their government in the wake of the military regime, has prompted these groups to attempt to use the courts to block actions to which they are opposed. It also can be exploited by groups opposed to the reforms necessary to modernize Brazil's economy.

The court battles over privatization reflect this trend. Numerous disputes have been raised with respect to issues such as the valuation of state-owned companies, the sectors that should be opened to foreign participation and the proper allocation of the revenues from the sale of state firms. Such disputes explain, at least in part, why privatization has proceeded slowly in Brazil. Along the same lines, companies that are likely to be negatively affected by proposed reforms, such as those in a sector enjoying protection from foreign competition, can petition the courts, knowing that, at the very least, they can delay the proposed reforms while the courts reach a decision.

Brazil's chronic economic instability also accounts for the increase in the volume of court cases. Each of the successive economic plans enacted by the federal government between 1986 and 1990 completely changed the rules regulating the adjustment of financial obligations for inflation, which sometimes varied from one obligation to another. In a country with a monthly inflation rate ranging from 15 to 80 percent, the adjustment of obligations for inflation may determine whether a business transaction is feasible or not. The confusing rules enacted as part of these economic plans has resulted in an enormous number of disputes between parties with different understandings on how to adjust a certain obligation for inflation.

Although the volume of court cases pending today is extremely high, the management of the court system is still very weak and inefficient. The courts have not yet designed and implemented a uniform policy and an internal control system that would guarantee more efficient results. Internal controls over court clerks, judges and justices are not effective. In general, court officials work only as many hours each day as they feel are sufficient. It is common to have two courts in a city, one with a hard-working judge, and the other with a lazy judge. The result is that one court is efficient and the other is not. The same applies to court clerks. Of course, it would make no sense to suggest that judges or justices should have their daily work hours controlled.

The management crisis also affects criminal justice and the law enforcement system, which have been extremely inefficient in effectively prosecuting and punishing those who commit a crime. With respect to the criminal courts, the volume of cases has also exceeded capacity, and controls over judges and court clerks, if any, are also very weak. Consequently, judicial proceedings are slow and sometimes useless. A popular joke in the criminal courts is the story of a woman who filed a court case to obtain authorization to have an abortion because she was raped, but when the court granted her request, her son was already 10 years old.

### **The Judicial System and the Other Branches**

Since the political opening of the mid-1980s, the Brazilian judicial system, as noted above, has significantly improved its capabilities as an independent and serious institution. Despite its slowness and inefficiency, it is finally assuming its responsibility for guaranteeing that new laws do not violate the constitution or other statutorially higher legislation. Reflecting the growing pains of a new democracy, the executive and the legislative branches have passed laws without first determining whether they violate the constitution or other legal provisions that may be statutorially higher than the proposed legislation. However, because of recent court decisions contesting the validity of proposed laws, the executive and legislative branches are gradually becoming more careful with the legislation they propose and approve. Examples of judicial review cases concerning federal legislation dealing with new taxes and salary adjustments are described in the box at the left.

### **Corruption in the Judicial Branch**

Corruption in Brazil not only affects the business climate, but undermines the prospects for successfully establishing the rule of law. Corruption can be found throughout government and poses a major threat to Brazil's economy and democracy. In the judicial branch, corruption has emerged within the law enforcement community, due to a lack of financial support and poor administration. Police officers are usually poorly trained and are provided with no ongoing educational program. In addition, salaries are extremely low, police precincts are poorly equipped and the basic equipment they have is not properly maintained. For example, it is not uncommon to have police agents using their own typewriters in police precincts in Rio. The same applies to all other types of office supplies and basic working tools, such as cars, weapons, etc.

Inadequate training, together with low salaries and poor working conditions, results in an inefficient law enforcement system that is vulnerable to corruption. Crime is not prevented adequately, and the criminal court system is unable to punish those individuals who are prosecuted, because most criminal cases start with and depend on a preliminary police investigation (inquirito policial).

### **Controlling the Police**

Corruption also results from the lack of control over the activities of law enforcement agents (military and civil police agents especially). These agents, of course, have the power to prevent crime and arrest perpetrators; they also have a strong sense of self-protection and basically act as if they were above the law. Some law enforcement officials take the law into their own hands to protect or avenge fellow policemen, or perform privately contracted acts of vigilantism.

The Vigrio Geral massacre in Rio de Janeiro on August 31, 1993, is a sad example of this type of free-handed activity. The day after four police agents were killed by drug dealers in that area, approximately 30 men went to the Vigrio Geral area and randomly killed 21 people. All evidence indicates that the killing of the four policemen, which triggered such a horrible reaction, was caused by bickering over protection money. Clearly, such events do not reinforce an image of the police as protectors of a free society.

Thanks to pressure from the mass media and general public indignation, the state authorities have conducted a far-reaching and effective investigation, which resulted in the arrests of 16 policemen less than a week after the event. The evidence obtained thus far indicates that most of the participants in this massacre were policemen.

While the Vigrio Geral massacre stands out as the most horrifying corruption case, it is unfortunately not the only one that needs to be investigated and solved. The authorities are not putting the same emphasis on thousands of other cases that have not received the same amount of publicity, and that are still awaiting action at police precincts, prosecutors' offices and courts all over the state. Much work lies ahead for those who lead grassroots pressure for effective law enforcement.

### **Corruption in the Executive and Legislative Branches**

A similar effort awaits those who seek to reform the behavior of policy makers. The executive branch in Brazil still acts as if the constitution and existing legislation can be amended at its discretion. Meanwhile, Congress has yet to assume its rightful role as an independent branch of government responsible solely for reviewing and developing a set of laws coherent with the Constitution and aimed at providing the country with mechanisms for economic and social development.

Nevertheless, the corruption scandals that have arisen since the impeachment of President Collor in 1992 are unquestionable proof that the country's institutions are helping consolidate democracy, albeit in fits and starts. Corruption existed in Brazil long before the tenure of President Collor and his advisors. However, for the first time in Brazil's history, a corruption scandal was seriously investigated and the president of Brazil faced impeachment and prosecution. In addition to and as a result of his impeachment, President Collor also had his right to run for public office suspended for eight years and is today being criminally prosecuted, together with some of his advisors.

Some observers have expressed frustration over the fact that President Collor is not in jail. However, careful analysis suggests that this is also proof that Brazil's democratic institutions are working properly. The Brazilian Constitution guarantees due process of the law to anyone who is prosecuted before a Brazilian court, including President Collor. President Collor certainly acted wrongfully and may have committed crimes; the evidence presented to the public in general by the mass media seems to be strong enough to put President Collor in jail.

However, the media cannot be the ones to decide. The court of jurisdiction must review all the charges and evidence carefully before it can determine that President Collor is guilty of a certain crime or order him to indemnify the Federal Union for wrongful acts. Based on the investigations conducted by Congress, lawsuits were filed against him and he has been guaranteed the right to defend himself in these lawsuits. The fact that someone in a position as high as president can undergo an orderly trial demonstrates the strengthening of government by rule of law—a key element of a democratic political system.

The Congressmen involved in the budget scandal currently being investigated by congressional subcommittees are expected to suffer the same fate as President Collor. The evidence collected during these investigations will determine which of these Congressmen are guilty and shall go to jail immediately and whether or not the allegations reported by the mass media are true. Although the media have a very important role in the democratic process, investigating and communicating their findings to the public, such findings must not be accepted as the truth without due process of law, guaranteeing the defendants the right to a full defense and fair trial.

### **External Controls over the Courts**

The Supreme Federal Court's decision on the IPMF law (see box on p. 24) has generated a very intense discussion on the need for external controls over

the courts. Congressmen have been arguing that the Supreme Federal Court cannot revoke a law approved by more than three hundred Congressmen. This would be true if the Supreme Federal Court had not suspended collection of the IPMF to guarantee the enforcement of one of the most important principles contained in the Federal Constitution, which is statutorially higher than a federal law.

The Congressmen advocating the idea of external controls over the judiciary, however, have not defined clearly how such controls would function. Some Congressmen say that the judges should be freely elected, rather than selected through public written and oral examinations. Others say that the constitution should create a commission to exercise control over the courts, without giving details on who should form such a commission or how it should function. The discussion on the need for external controls over the courts, however, is still on-going, and such controls are not likely to be included in the Constitutional reforms to be implemented within the coming months.

A proposed change in the appointment of judges (through free elections rather than public exams) may also result in a less efficient court system. It is logical that a judge who is elected (and who may or may not be re-elected) will be more vulnerable to the pressures of the mass media and more interested in being popular than a judge who passed a public examination and cannot be removed from office other than for serious wrongful acts. Such a nonaligned judge can make less biased decisions on the validity of laws.

### **Reforming the Judiciary**

Since the judicial crisis is more a managerial crisis than anything else, any controls should be limited to the management of the court system. Effective controls would empower professional managers, rather than judges, to run the courts. Any controls on the merits of court decisions, on the other hand, would probably be a disaster. This type of control is and must be exercised by the courts, organized at different levels, so that the parties to litigation will have the opportunity to have a case decided by two or three different courts and by several judges and panels of judges.

The Labor Courts of Rio de Janeiro provide a good model for the management reforms that are needed. The Appellate Labor Court, also responsible for the lower Labor Courts, recently decided that the courts should also open to the public in the morning, not only in the afternoon (as occurs in most courts in the country). Also, the Appellate Labor Court recently began not only to monitor closely the productivity of each judge, based on the number of cases decided, but also to question those judges who do not perform adequately. The Labor Courts of Salvador decided to assign two judges to each lower Labor Court, so that each court could have hearings throughout the entire day, from Monday through Friday. While one judge presided over a hearing, the other would be rendering decisions. The results in these two cases have been very positive.

The independent role assumed by the courts in evaluating legislation will gradually reduce the degree of uncertainty in the economic environment for the public in general as well as for local and foreign investors. The judiciary's power to block lawmaking that does not meet constitutional and statutory standards must be left intact, for individuals' willingness to invest in a country's economy depends in large part on the clarity of its laws.

The management crisis in the Brazilian judicial system will not be solved with amendments to the constitution. The crisis will only be resolved through changes in attitudes among the executive branch, Congress and the judiciary and through more efficient management practices. These changes should result in the enactment of more permanent laws, decrease the volume of existing

court cases and process the backlog of pending cases more expeditiously.

### **Consolidating Brazilian Democracy**

In the short-term, Brazil's economic and political climate will likely remain turbulent. Uncertainty, perhaps best symbolized by the country's high inflation and economic chaos, has become practically a way of life, one to which citizens and investors, whether this is a good thing or not, seem to have become accustomed. The key issue, then, is whether Brazil will develop the political and institutional maturity necessary to consolidate democracy and achieve economic stability.

The level of economic health in the country will undoubtedly have a significant impact on how effectively other reforms can be implemented. The political opening achieved with the return to democracy in 1985 has not modernized the Brazilian economy, which still feels the government's strong presence in most areas. The preponderance of state-owned companies, the abundance of regulations designed to protect them, and the illusion of being able to solve the economy's structural problems by quick-fix shock programs have contributed to a chaotic economic situation.

There are encouraging signs, such as the growing intolerance of political corruption and the judicial checks on legislative overreaching. The rule of law may yet take hold, giving democracy a firm foundation on which to prosper. Moreover, the constitutional review provides a unique opportunity for the country to implement the structural reforms necessary to modernize and stabilize its economy, particularly by controlling the reckless public spending that fuels inflation and by easing the stifling state controls on labor mobility and market entry.

It is an opportunity that should not be squandered. Investors have long been willing to overlook Brazil's chronic instability because of the country's size, the attractiveness of its market and its well-endowed resource base. However, the dramatic birth of stable democracies and open, market-based economies in other Latin countries has greatly enhanced their competitiveness and threatens to overshadow Brazil's traditional advantages. If not remedied, Brazil's chronic chaos may well prompt investors to look elsewhere.

### **JUDICIAL REVIEW AND ECONOMIC POLICY IN BRAZIL**

While judicial review may signal a stronger judicial branch, it does not necessarily imply greater economic stability. The cases presented in this box show how judicial review has increased economic uncertainty in two key areas: salary adjustments and new taxes.

- Salary adjustments—Since democracy emerged in Brazil in the mid-1980s, the federal government has enacted a series of economic "shock" programs in attempting to establish macroeconomic stability by bringing inflation under control. First, there was the "Cruzado Plan" in 1986, followed by the "Bresser Plan" in 1987, "Verão Plan" in 1989 and "Collor Plan" in 1990. However, the wage and price freezes featured in these plans often have come into conflict with salary adjustment provisions contained in federal legislation.

When the Bresser Plan was adopted in June 1987, for example, the salary adjustment law in effect provided that salaries should be adjusted for inflation whenever the cumulative inflation rates within a previous twelve-month period reached 20 percent. Since inflation was not under control in 1987 and the monthly rates were usually beyond 20 percent, salaries were being adjusted for inflation almost on a monthly basis (i.e., whenever the prior month's inflation rate exceeded 20 percent).

On June 15, 1987, the Executive Branch decreed that, as of July 1, 1987, salaries would be frozen (i.e., the July 1987 salaries would equal the June 1987 salaries). Based on this decree, employers did not adjust their employees' July 1987 salaries based on the June 1987 inflation rate. The June 1987 inflation rate, however, was 26.05 percent. Labor unions and individual employees began filing claims arguing that when the new law was enacted, the employees had already acquired the right to have their July salaries adjusted based on the June inflation rate, which, they contended, had occurred mostly or even totally before enactment of the Bresser Plan's freeze of prices and salaries.

After years of litigation and several decisions for both sides, the Superior Labor Court enacted a Precedent Rule (Enunciado de Súmula) establishing that the 26.05 percent salary adjustment as of July 1, 1987 was due. Although this decision may be fair to the employees, it is certainly unfair to those companies that could not adjust their prices as a result of the Bresser Plan. Now these companies face a court decision ordering them to adjust their employees' salaries as of July 1987 at the rate of 26.05 percent and to pay all salary differences accrued as a result thereof over the last five years (the statute of limitations applicable to employment-related benefits is five years).

- New taxes—Another recent example of judicial review over legislative proposals involves the legislation creating the Provisional Tax on Financial Transactions (Imposto Provisório sobre Movimentações Financeiras [IPMF], which is levied on any financial transaction at a rate of 0.25 percent. The creation of this tax was proposed by the Executive Branch and approved by Congress, which passed a constitutional amendment for this purpose. Immediately after Congress' approval, the Federal Revenue Service began collecting the IPMF. Little more than a month later, however, the Supreme Federal Court suspended the effects of the IPMF law, arguing that, according to the Federal Constitution and the National Tax Code, a new tax cannot be collected in the same fiscal year it was created, but only as of the subsequent fiscal year, regardless of the Constitutional Amendment passed to permit the IPMF's creation and collection.

#### **BRAZIL'S CONSTITUTION: AN OBSTACLE TO ECONOMIC MODERNIZATION**

The current Brazilian constitution contains numerous provisions that curtail the economic modernization necessary to make Brazil more competitive. To their credit, Brazilian leaders recognize the need for revisions in the 1988 constitution. A constitutional review was recently initiated in the Congress. Unfortunately, the congressional corruption scandal has absorbed Congress' attention and delayed the review process.

One major problem with the current constitution is that it limits both competition and the growth of the private sector, by restricting foreign investment in potentially high-growth industries, such as mining and transport, and by guaranteeing state monopolies in strategic areas (e.g., telecommunications, petroleum). Moreover, because of chronic budget deficits, public investment in these key sectors has been limited, resulting in inefficiency and technological backwardness.

Ironically, the constitution itself is a source of these deficits. To decentralize power in the wake of the dictatorship and redistribute wealth to Brazil's poorer regions, the 1988 constitution mandated increased federal revenue transfers to state and local governments without corresponding cuts in federal spending. Despite its declining revenues, the federal government remained obligated to finance education, health and other public services. In addition, the constitution mandated the amount of public spending on these services; 18 percent of total tax revenues, for example, has to be spent on education. These mandates limit the government's ability to cut spending.

The constitution's labyrinth of labor laws also exerts upward pressure on federal spending. An overly generous pension system now covers 14.5 million Brazilians, whose state retirement benefits now cost about US\$6 billion per year. With contributions much lower than outlays, the social security system is nearly bankrupt. Public sector salaries, meanwhile, now account for 11 percent of the government budget, reflecting the bloated payrolls of state enterprises and an unrealistic minimum wage. The national minimum wage, in fact, ignores regional economic diversity, forcing many employers, especially in Brazil's poorer northern regions, to recruit workers through the informal sector. The constitution and other labor rules make employee dismissal cumbersome and expensive. The result of the various labor provisions is a rigid labor market that discourages investment and raises costs, for both public and private employers.

Brazil's chronic high inflation can be attributed to high public spending, but the current constitution limits the federal government's ability to cut spending. The government's debt interest payments consumed 17 percent of its budget last year; coupled with the spending mandates, Brazil faces grim alternatives to budget cutting, like increasing the money supply or borrowing at high, short-term rates. Without constitutional revisions that allow responsible federal spending, Brazil is unlikely to bring inflation under control, perpetuating a climate of economic instability.

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