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Governance under Lula's
new term

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The Executive branch's governance and its capability to rein in support from the Federal Legislature is a trending topic. Over the years, the mainstream view shifted towards an understanding that the Executive branch had lost some of its influence due to political parties' fragmentation.

Bolsonaro's administration, at the very start, looked to end the "tit for tat" approach to politics and not to employ a political distribution of ministries (departments in the American government), rendering more Congress autonomy, thus reducing the President's ability to dictate budget allocation.

Such dynamics shaped the perception that Lula's third mandate would face a similar limitation in approving fiscally expansionist proposals or reviewing/revoking reforms implemented in previous administrations.

We beg to differ. We believe governance will not be an active restriction during his third term. On the contrary, we foresee a favorable scenario for President Lula to approve his bills.

His campaign was not anti-politics, such as Bolsonaro's: Lula instead made his bid for office with a broad coalition, chose his old foe as vice president, and, once more, set up his cabinet's core from among his own party's members (*PT* in Portuguese – Workers' Party), but which also comprises parties with important representation in Congress.

In a study carried out after first-round elections¹, we argued that governance in a renewed Lula administration would not be as bad as commonsense would have it and would depend on the considerably heterogeneous Liberal Party (*PL* in Portuguese – Partido Liberal). In the present study, we dive into the leveraging mechanisms available to the new administration to widen its grip on Congress and the effects of the 2017 political reform, which has already shown tangible results in reducing partisan fragmentation.

The economic implication of good governance is dubious. As previously stated in our "Lula from a fiscal policy perspective," Lula's administrative priority has always been the expansion of social spending. Fiscal consolidation was often put on the back burner. Considering the elected president's indications and the ministries' profile, this will remain the motto during Lula III. With Congress somewhat on board, we do not see significant impediments to this strategy's implementation.

The doubt is if such governance will suffice to gather support to implement measures that will increase tax collection to counterbalance government spending expansion. As previously discussed in our letter "Searching for a Gregorian horizon," the topic "tax hike" is taboo in Brazilian politics, given society's perception of an already excessive tax burden.

¹ [Congress after 2022 election, Oct. 2022](#)

This topic is even more delicate because of the geographical characteristics of tax collection vs. votes. Tax hikes would be a more significant burden for pro-Bolsonaro regions. The geographical perspective might well be the seeds for a social and ideological conflict fought in public debate and Congress.

Political Platform (vs. Bolsonaro’s Antipolitics)

According to Sérgio Abranches, forming a coalition before government effectively takes place is composed of two steps. The first is forming the electoral coalition, which involves defining a political agenda; that is, it tends to bring together parties with a similar political platform. In this regard, Lula formed his coalition in 2022 and united closely related parties, such as his own Workers’ Party (PT in Portuguese), Communist Party of Brazil (PCdoB), Socialism and Freedom Party (PSOL), Green Party (PV) and Sustainability Network (REDE), but also former São Paulo State Governor, Geraldo Alckmin (vice-president), from the Brazilian Socialist Party (PSB). The former Brazilian Social-Democracy Party (PSDB) member, as vice-president, was not intended to portray distancing from the left’s radical ideas, as was the case with José Alencar back in the 2002 bid, but rather an attempt to purport PT’s candidacy as a broad coalition, capable of defeating the so-called Bolsonaro “fascism.”

In this context, Lula managed to be elected with a broad coalition but still falls short on securing major voting in the Chamber of Deputies. This takes us to the second step, as per Abranches: the distribution of power among parties in order to drum up support.

Figure 1: Seats in the Chamber of Deputies in 2023

Coalition	139	Center	272	Opposition	102
Fé Brasil ²	80	MDB	42	PL	99
Avante	7	PSD	42	Novo	3
PDT	17	Podemos	18		
Solidariedade	7	União Brasil	59		
PSB	14	PSDB/Cid.	18		
PSOL/REDE	14	Patriota	5		
		PP	47		
		Republicanos	41		

Source: National Congress, Mar Asset Management

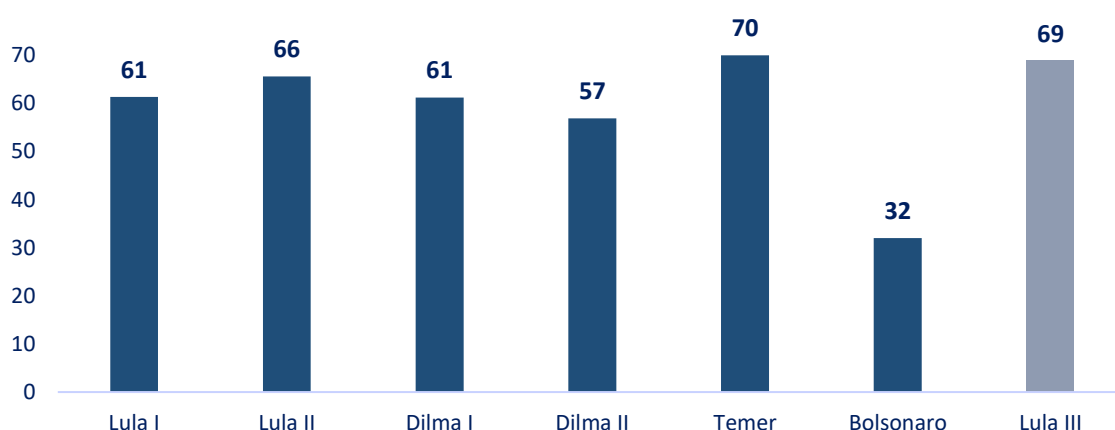
With a campaign platform portraying a broad government base, there is no rein on Lula to prevent him from making political appointments. The novel President could split up the public budget to bring in other parties, or factions thereof, into this government coalition.

² Party Federation composed by and of PT, PCdoB e PV B e PV

This aspect contrasts with Bolsonaro’s approach. Data from the 2020 and 2023 PLOAs (annual budget bill, as per the LDO, Law of Budget Guidelines) show that in his opening year as president, Bolsonaro put nearly 30% of the budget in the hands of politically appointed ministers. Early into Lula III, some figures suggest that 80% of the budget will be available to politicians, 50% with PT, and 30% split among PCdoB, PSB, PSD, PSOL, Rede, MDB, PDT, and União Brasil.

Another way of understanding how the distribution of ministerial offices in Brazil is related to the Chamber’s partisan makeup is the coalescence rate, which measures the ministries’ proportionality about the weight of each party composing the government’s coalition in that House. The coalescence rate varies from 0 to 100, and the higher the proportionality, the higher the weight of each party in ministerial offices and its presence within the Chamber.

Figure 2: Chamber’s coalescence rate at the onset of the mandate



Source: Atlas do Estado Brasileiro, Amorim (2002), Mar Asset Management

The ministerial makeup announced by Lula grants him one of the highest coalescence rates of the century. With a very close figure, Temer approved the Spending Cap and the Labor Reform. A high coalescence is not a sine qua non condition to pass reforms, given that Bolsonaro also approved a Social Security reform in his inaugural year in office. Without question, though, a higher coalescence reduces inherent costs.

Lula would gain tremendous strength within the Chamber, should he succeed in expanding his original electoral coalition into the parties that benefitted with ministries. If he can draw support from all deputies (House Representatives in the American government) from parties comprising his expanded base, his administration will amass 268 votes. If weighted by the estimated partisan loyalty index for this next term, he could count on approximately 219 votes. However, winning over such support depends on not only

assigning offices to other parties but also appointing relevant politicians to harness support from ideologically heterogeneous party blocks, such as União Brasil.

Figure 3: Lula III Government Coalition

	Seats	Weighted³
Fé Brasil	80	77
PDT	17	15
PSB	14	12
PSOL/REDE	14	9
MDB	42	36
PSD	42	34
União Brasil	59	35
	268	219

Source: National Congress, Mar Asset Management

Approving a PEC (constitutional amendment proposal) requires 358 votes, while a LC (Supplementary Law) demands 257. Lula still needs further support in this context. Therefore, the second trade-off between the Executive and Legislative branches – aside from ministerial office appointments – is relevant. Amendments offered by either house of Congress work, in theory, to supplement the ministerial office's apportionment: the fewer offices distributed, the more the budget needs to be diverted to amendments to purchase support from congresspersons and vice versa. See Bolsonaro's case.

Through a provision inserted into the Transition PEC (after the General Rapporteur's amendments – budgetary heading RP9 - were deemed unconstitutional), the Chamber ensured that half of the resources destined to the RP9 would now shift to mandatory amendments. The other half would be under the Executive branch's watch (budgetary heading RP2); however, the legislator in charge of rapporteurs is still responsible for overseeing the resources' allocation. In practical terms, the bargaining chip between the two branches is still in place. Thus, this is still a means for PT to obtain support for its proposals. Another aspect of the Transition PEC negotiation process that surfaced was the relationship established between the Chamber's President, Arthur Lira, and then President-elect Lula. Counting on support from Lula's PT, Lira will ensure his reelection and power over the budget. With Lira, as of now, satisfied, Lula will find it easier to implement his agenda, given that it dissuades opposition from a critical "veto player."

³ Weighting performed by the Governance Index, explored in more detail in the next section.

Barrier Clause

In 2017, Congress passed a Constitutional Amendment, also known as the barrier clause, which sets conditions for political parties to access the public Party Campaign Fund and free TV time based on their electoral performance. These norms came into effect in the 2018 election, and their effects are now visible in the 2023 Chamber's membership.

The reasoning behind the barrier clause is to avoid the high proliferation of political parties in a proportional system. This argument is rooted in the idea that a hyper-fragmented Legislative branch stands in the way of governance, making coalition mechanisms to form congressional majorities more complex. Reducing the number of political parties would create greater stability for the party system and, thus, lower governance costs.

The major mechanisms approved to curb party fragmentation are (i) the ballot performance clause, implemented gradually, and (ii) the cessation of election-only party coalitions in proportional elections.

The performance clause itself is as follows:

- 2018 elections: Parties would have to obtain, in the Chamber elections, **at least 1.5% of the valid votes**, spread throughout at least one-third of States, with a minimum of 1% of the valid votes in each of them, **or have elected at least nine deputies**, in, at least one-third of States.
- 2022 elections: Parties would have to obtain, in the Chamber elections, **at least 2% of the valid votes**, spread throughout at least one-third of States, with a minimum of 1% of the valid votes in each of them, **or have elected at least 11 deputies**, in, at least, one-third of States.
- 2026 elections: Parties would have to obtain, in the Chamber elections, **at least 2.5% of the valid votes**, spread throughout at least one-third of States, with a minimum of 1.5% of the valid votes in each of them; **or have elected at least 13 deputies**, in, at least, one-third of States.
- 2030 elections: Parties would have to obtain, in the Chamber elections, **at least 3% of the valid votes**, spread throughout at least one-third of States, with a minimum of 2% of the valid votes in each of them, **or have elected at least 15 deputies**, in, at least, one-third of States.

The parties that fail to meet these minimal standards can no longer access public money for campaigning and are compelled to merge with other parties.

The proportional elections coalitions ceased as of 2020 and limited parties’ capacity to come together indiscriminately for election purposes only to obtain more resources from the Partisan Campaign Fund and gratuitous television time during campaign season. This measure stimulated the formation of partisan federations, in which alliances must last for at least four years and work as a single party block in Congress – forcing such alliances to take place among parties with more compatible platforms.

Before the 2022 elections, three federations came about, and the PSL (Liberal Social Party) merged with DEM (Democrats) to conform with União Brasil. Furthermore, five parties (with Chamber representatives) failed to meet the barrier clause standard after the elections, and four of them announced a partisan merger process. Only one of them, i.e., Novo, remains solo.

Figure 4: Mergers and federations stimulated by the Barrier Clause (# of deputies)

Federations	Parties	Merges	Parties
Fé Brasil	PT (68) PCdoB (6) PV (6)	Solidariedade	Solidariedade (4) Pros (3)
PSDB/Cid.	PSDB (13) Cidadania (5)	Podemos	Podemos (12) PSC (6)
PSOL/REDE	PSOL (12) REDE (2)	Mais Brasil	PTB (1) Patriota (4)

Source: National Congress, Mar Asset Management

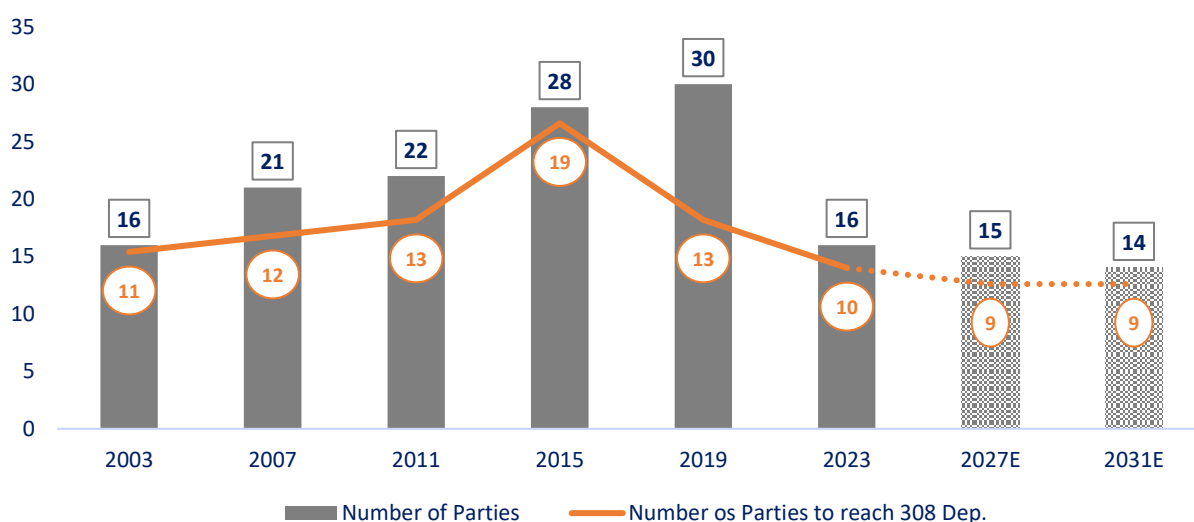
All three federations and party mergers have met the barrier clause with the 2022 rules in force. However, *caeteris paribus*, looking at restrictions set forth for 2026 and 2030, we find:

- The *Solidariedade/Pros* merger will not satisfy the 2026 standards (nor 2030)
- The *PTB/Patriota* merger does not meet the requirements for 2030.

These changes’ effects on the new Chamber membership makeup are clear. Firstly, there was a reversal of the trend observed in 2002, when the number of parties with representatives in this House began increasing. While the 2019 presidential term debuted with 30 parties, 2023’s term will only have 16 (considering the federations and mergers in place). After that, supposing parties that fail to meet the barrier clauses in an election

cease to exist (or merge into larger parties) in the coming election, we shall have an additional reduction in the number of parties within the Chamber.

Figure 5: Number of parties with seats in the Chamber at terms' start

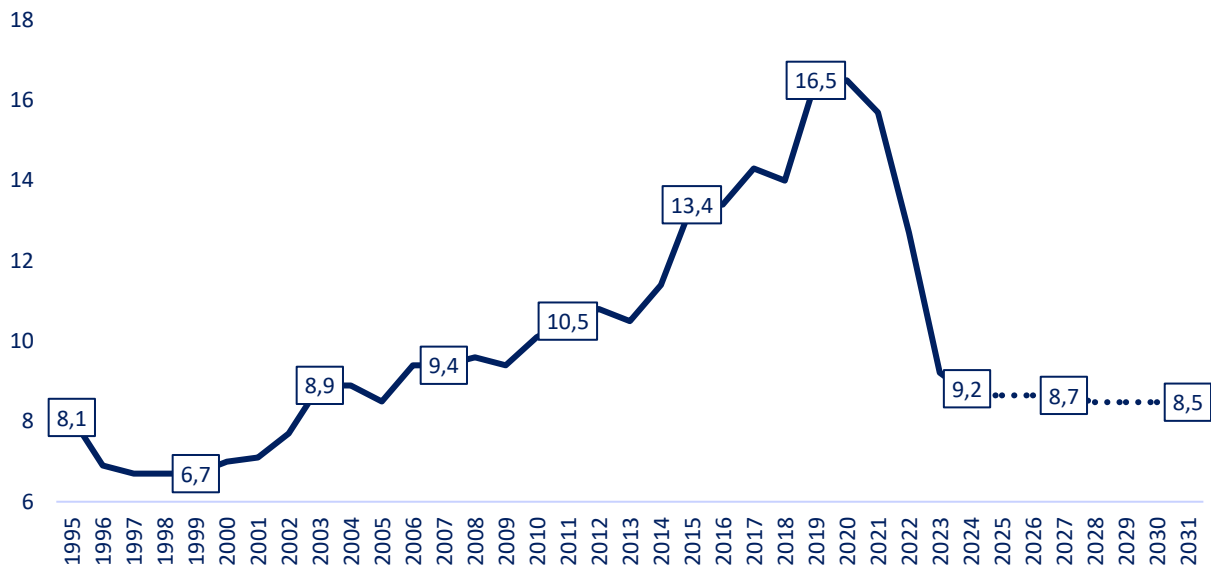


Source: National Congress, Mar Asset Management

Analyzing the number of parties alone at the beginning of the term may lead to misunderstanding. For instance, if tiny parties unite, we will reduce the number of parties, but Congress' dispersion would not change significantly. For this reason, it is common to calculate the Effective Number of Parties (ENP), which results from the inversion of the Herfindahl Index (HHI) – calculated by squaring each party's share and then summing the resulting numbers in relation to the total number of deputies.

With the ENP, we verified the deputies' concentration level among the parties. The concentration has increased since early 2022 when DEM and PSL merged to form União Brasil. This year's election result sped up the trend due to the enforcement of alliances via barrier clause and the polarized result from the ballots. Supposing that, in the 2026 and 2030 elections, the deputies belonging to extinct parties are evenly distributed among the remaining ones, the increase in concentration will be marginal in the future. That is, most advancements to governance, deriving from the barrier clause, are already present in the current legislative session.

Figure 6: Effective Number of Parties



Source: National Congress, Jairo Nicolau, Mar Asset Management

PL's Behavior and Governance

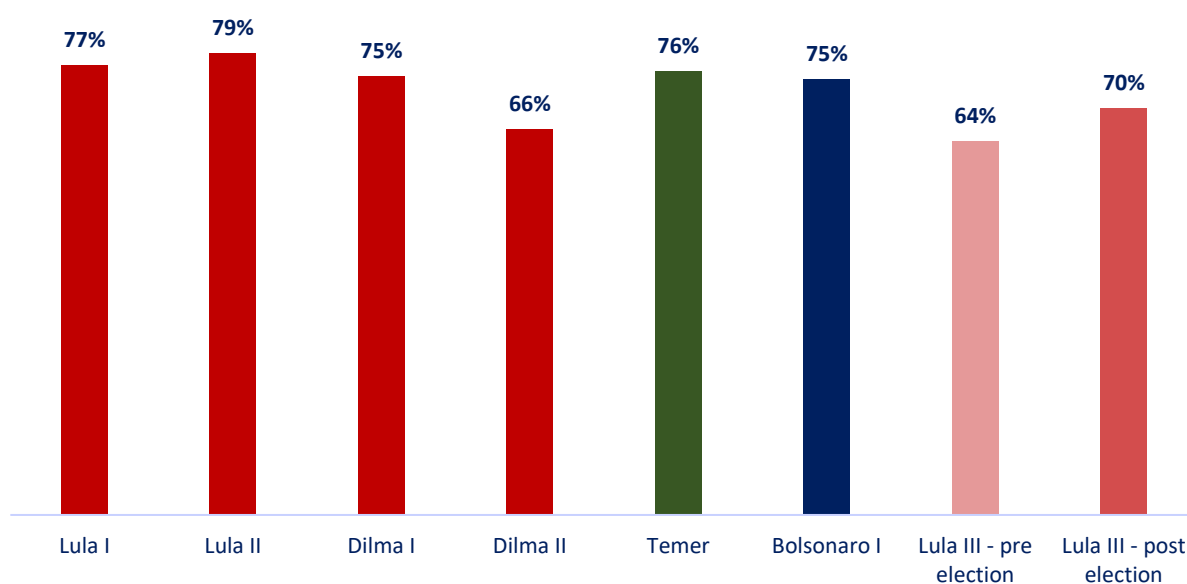
Before the second-round run-off voting, we sought to understand how governance would work under a future Lula III. We have further informed this analysis with the mergers announced after the election and the voting data from the Transition PEC, besides diving deeper into the new PL party makeup in the Chamber. Thus, we believe in having a better projection for the Governance Index (GI) for Lula's third term.

We can divide the new PL seats into four different groups. Nearly 50% of these deputies were elected on a highly pro-Bolsonaro platform and are the most likely to oppose Lula's administration. These deputies were assigned a GI close to 20 during Bolsonaro's term in office. As a comparison, PT-member deputies, such as Reginaldo Lopes and Paulo Pimenta, reached a GI close to 20 during Bolsonaro's term. From the other half, two-thirds are legislators that took part in past PT governments, to whom we assigned an average GI for their previous participation. The rest are newly-elected deputies, but with a shy pro-Bolsonaro platform, and reelected legislators who voted in favor of the Transition PEC, to whom we assigned GIs of 40 and 90, respectively. Taking stock of the entire PL configuration, we came up with a GI of 38 for PL.

For the other parties, we employed the average between the historical GI during PT administrations and the proportion of deputies from the party that voted to pass the Transition PEC.

Under these new hypotheses, the result is an estimated GI of 70 for the Lula III mandate. This represents an increase of 6 points compared to our projection before the second round of presidential elections. It is still below the historical average of previous governments mainly due to the PL's opposition – which boasts the largest membership within the Chamber. We should pay attention to a hypothetical non-computable gain due to the lower number of parties within the House, which could indirectly benefit negotiations and raise GI for each individual party.

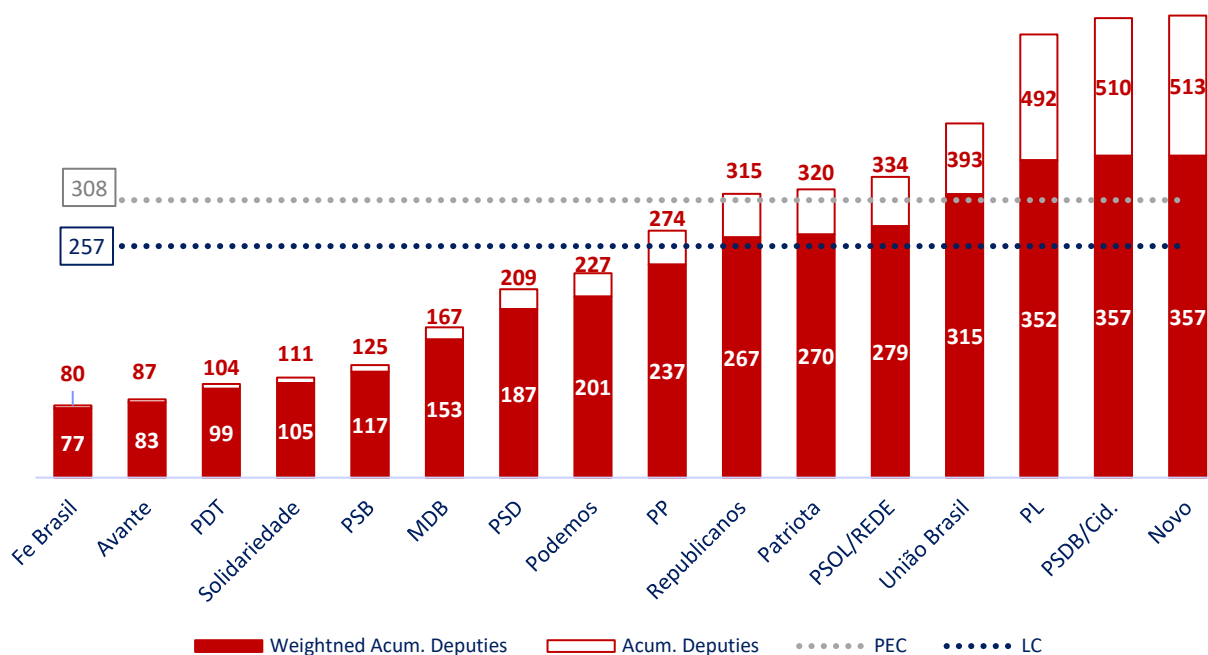
Figure 7: Governance Index in different Legislative Terms



Source: National Congress, Estadão, Mar Asset Management

To understand more clearly how difficult it would be for the President to pass a PEC or an LC, for that matter, we have ranked parties by their estimated GI and utilized it in weighting the number of seats each one of them holds. We have calculated the number of votes expected from each party.

Figure 8: Accumulated votes in the Chamber ranked by Governance Index



Source: National Congress, Mar Asset Management

With the Transition *PEC*, the new government loosened the regime required to approve a new fiscal rule, which now can be submitted as a Supplementary Law (*LC*) bill. In practice, not only does it make the current spending cap obsolete, but it also favors political negotiations. From the perspective of the proposal mentioned above, the Federal Government would have to encompass ten parties/federations to approve a new rule via *LC* (*Fé Brasil* to *Republicanos*). At the same time, for a *PEC*, it would need 13 (*Fé Brasil* all the way up to *União Brasil*). It is important to note that this is a conservative perspective, given that we suppose the parties beyond the marginal party would contribute with zero votes. That is, the parties that do not integrate the ruling party's base would have a null GI. As such, approving a *PEC* seems feasible no matter how the *PL* behaves.

Figure 9: Main Proposals from the Government

Proposals	Legislation	Proceeding	Marginal Party	Marginal IG
Tax Reform	PEC	PEC 45/110	União Brasil	60
Income Tax Reform	LC	PL 2337	Republicanos	73
New Fiscal Rule	LC	-	Republicanos	73

Source: National Congress, Mar Asset Management

Conclusion

The appointments for ministerial offices to form a broad coalition in Congress, the reduced number of political parties within the Chamber, and an opposition block, although significant but rather heterogeneous, are all forces that point towards a greater capacity for the new government to approve proposals.

The general idea that a new president Lula's term would be fiscally responsible had been grounded in the memory of his earliest term in office, as well as in the legislative elections result with a more center-right wing trend.

Concerning Lula I, we have recently posted a study showing that the starting point the president faced in 2002 was quite different. Still, again his initial choice back then was also different from 2022. While 2003 was notorious for cutbacks on investment - along with tax collection increase - which allowed for augmentation of social spending in the following years, 2023 will start with a primary 2% deficit of GDP due to the recently approved PEC, granting a R\$168 bn waiver to the government.

Nonetheless, 2023 sees itself without a clear-cut fiscal rule, given that the spending cap has become obsolete, and PT must propose a new framework capable of promoting convergence to the public debt. All the more important, the party has to find a way to make the primary accounts compatible with the new rule.

Regarding the Congress' capacity to restrain increased public spending, we have shown above that Lula's governing capability is congruent with previous presidents that managed to carry out structural reforms. The President's and his ministers' speeches call for more spending, and it seems Congress will not duly oppose it.

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