

Political Corruption and its Effects on the Government's Ability to Provide Essential Public Goods in Brazil

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In June 2015, the Chief Executive Officers of two Latin American construction giants, Odebrecht and Andrade Gutierrez, were arrested in the so called “Lava Jato” investigation. Emilio Odebrecht, father of the current president of Odebrecht SA, made a bombshell public statement that shocked Brazilian society; “If they arrest Marcelo [his son], they will have to pack three cells - One for me, one for Lula and yet another for Dilma.” (Odebrecht, quoted in Coutinho, Bronzatto and Escosteguy 2015) Political corruption involving the state owned oil company, Petrobras, was at the center of this scandal. With the help of corrupt politicians, billions of dollars that could be spent on public goods were deviated from Petrobras, in what is so far the largest corruption investigation in Brazil (Folha de São Paulo 2015). Despite reform efforts made in the last decades, corruption continues to undermine Brazil’s future. Previously called the “country of the future”, Brazil remains below its natural potential partly due to ongoing corruption and corruption scandals that compromise the country’s international and national credibility.

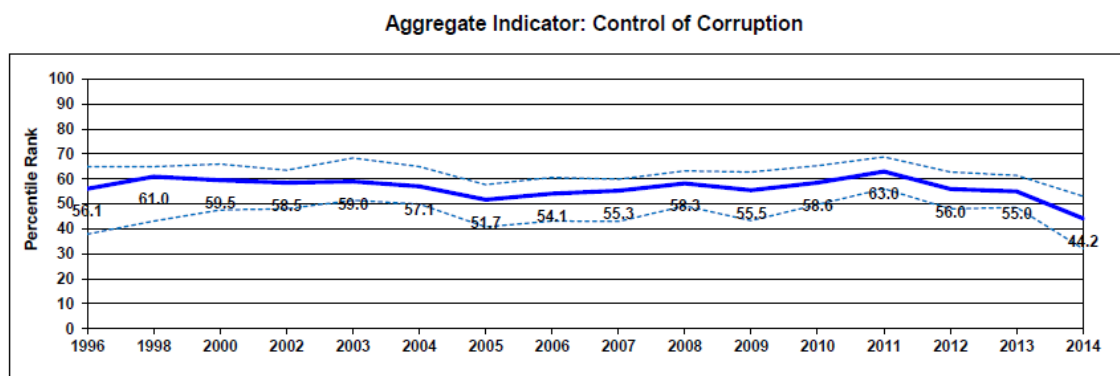
Brazil’s society desperately demands equal opportunity, better education, and national infrastructure that meet its development needs. This is especially significant since the weight of tax burden per GDP has increased from nearly 20% in 1970 to almost 35% in 2014 (Tribunal de Contas da União 2015). Corruption has not only political impacts, but also serious economic repercussions by deviating public funds, which cripples the government’s ability to provide public goods. The aim of this essay is to analyze the links between political corruption and the quality of the public goods provided by the government, with a focus on infrastructure and the recent “Lava Jato” investigation. First, what are the institutional incentives behind political corruption in Brazil? Second, what are the reasons why corruption specifically inhibits the development of proper infrastructure? This paper will argue that political corruption derives from a lack of coordination between accountability institutions and discretionary decisions. The reasons why corruption obstructs the development of infrastructure range from the deviation of money, to shifts in government priorities and influence on the bidding system.

Conceptualizing Political Corruption: Measures and Approach

Brazilians acknowledge corruption as the flaw that systematically undermines the country’s economic development (M. M. Taylor 2010, 95). Many times, corruption has taken the form of bribes in exchange for government concession. However, it may also include actions that are not necessarily illegal within institutions and situations that represent a conflict of interest. This paper concentrates on political corruption, defined by the OECD as “the misuse by

government or political officials of their governmental powers and resources for illegitimate, usually secret, private gain” (OECD 2007). Furthermore, this study will analyze the executive power as well as upper level corruption that involves presidents, ministers, and members of the congress in the last 20 years. Since Brazil’s return to democracy in 1985, there has not been an elected president with a clean record. Fernando Collor, the first president directly elected by the people in Brazil, became the first South American president to face impeachment for corruption. More recently, neither Lula da Silva nor Dilma Rousseff has escaped such corruption scandals. On the 2nd December 2015, the President of the Brazilian Lower House “Câmara dos Deputados” announced he had accepted the petition for opening impeachment proceedings against President Rousseff (Jonathan Watts 2015).

Brazil’s level of corruption is lower than the regional average, but it remains significantly higher than nations in the developed world. Public opinion polls hint that Brazil’s population has a much bleaker outlook than experts do on the field of corruption. Transparency International’s (TI) Global Corruption Barometer indicates that 81% of Brazilian respondents feel that political parties are corrupt or extremely corrupt (Transparency International 2013). While the Barometer measures public opinion, TI’s Corruption Perception Index reflects the perceptions of country experts. According to TI’s Corruption Perception Index (CPI) of 2014, Brazil ranks 69th out of 175 countries and 5th in Latin America (Transparency International 2014). Additionally, the World Bank’s Worldwide Governance Indicator - Control of Corruption shows that in 2014, Brazil achieved the worst result over the last two decades. This represents a warning signal for the Brazilian authorities.



Source: (The World Bank 2015)

Why is this happening? Weak structure of horizontal accountability is often pointed out as a major cause in facilitating political corruption within Brazil. Therefore, it is essential to evaluate the quality of Brazil’s institutions. The analysis adopts an institutional approach to corruption that focuses on the structures of government and bureaucracy. This perspective

expresses that the structure of institutions shapes individual behavior while corruption is a behavior in response to opportunities and risk. In analytical terms, Robert Klitgaard defines corruption as the sum of monopoly power and discriminatory authority, minus the current level of accountability (Morris and Blake 2010). Institutional theories like this conclude that corruption tends to be higher in nations with high levels of taxation, low salaries, high discretion levels, and red tape. Today, Brazil has a tremendous regulatory burden, its excessive bureaucracy delays decision making, and the state controls strategic sectors in the economy. In other words, there is room for discriminatory decisions that favor public-private exchanges within the investment in public infrastructure. The concept of horizontal accountability focuses on the role of intrastate institutions that keep the government accountable (Morris and Blake 2010). This mechanism is crucial because it can mitigate corruption on a daily basis; in contrast, vertical accountability is characterized as a retrospective mechanism and is constrained by the long periods of time between elections.

Horizontal Accountability

The transition to democracy bolstered the development of Brazil's institutions providing accountability. However, the personalization of power in leaders who try to remain above political institutions constantly weakens institutions, such as the Congress or the Judiciary (Rehren 2009). If executive power is dominant over the legislature and auditing bodies, arbitrary decisions based on non-neutral criteria occur. Thus, fewer public goods are made available by the government. A common characteristic of Brazil's accountability process has been the interdependence between institutions in order to complete their missions, which delays action (Power and Taylor 2011). Additionally, instead of fighting corruption in the early stages, the emphasis has been put on the investigatory stages when scandals ensue. The key to Brazil's intra-state accountability lies within institutions like the *Tribunal de Contas da União* (TCU), the Judiciary, and the *Ministério Público* (MP). The incentives of corruption are strongly intertwined with weaknesses found in these institutions.

Government audit institutions are critical in monitoring public spending; at the federal level, no institution is as important as the TCU. The 1998 Brazilian Constitution gave the TCU the role of assisting the National Congress in the exercise of external control over the government (Tribunal de Conta da União s.d.). The TCU is empowered to investigate all aspects of budget management and therefore to assess the irregularities of public spending. It can delineate the financial loss caused by civil servants, ban corrupt companies from future procurement

contracts, and can inspect all major processes of contracting public works. On the political spectrum, the TCU is empowered to ban officeholders involved in corrupt scandals from higher positions. In the 2014 TCU's Activity Report inspection on the 792 million dollars' loss caused to Petrobras by the acquisition of a refinery in Pasadena, Texas is particularly relevant (Tribunal de Contas da União 2015). As a result, some of Petrobras directors were accused of illegitimate management and the "Lava Jato" investigation reached unthinkable dimensions.

	2010	2011	2012	2013	2014
Total Benefit from control actions (in R\$ billions)	R\$ 26,69	R\$ 14,19	R\$ 12,7	R\$ 19.8	R\$ 6.12
Officeholders convicted	2885	3123	2120	2274	2650
Fines applied (in R\$ billions)	R\$ 1,47	R\$ 1,45	R\$ 1.312	R\$ 1.103	R\$ 2.079
Officeholders banned from higher position	103	157	89	104	97
Companies banned from contracting with the state	109	117	47	194	52
Number of public works with severe irregularities	13%	82,60%	62%	61,70%	56,90%

Source: (Tribunal de Contas da União 2010-2014)

Even though in 1999 no company was outlawed by the TCU, today the reality is very different. Year after year, a growing number of corrupt companies are being excluded from procurement processes due to their misconduct. Moreover, an increasingly number of fines have been processed. When it comes to implementing sanctions, the TCU depends entirely on other institutions such as the Judiciary and the *MP*. This link is acknowledged as the greatest defect in Brazil's auditing systems (Speck 2011, 144). Although the TCU effectively determines fines, in practice most of them are rarely paid. When the TCU bans candidates from running for office, they often make use of the regular courts. Due to this, the effects of the TCU's verdict are powerless until the court makes a final decision and they manage to register for elections. Hence, many of TCU's sanctions lack effectiveness, because they require cooperation with other institutions. Corruption finds incentives in the absence of coordination.

The application of the rule of law relies on a competent judiciary that imposes legal sanctions on corrupt officials. In Brazil, the federal judiciary, in opposition to the TCU, is reactive and its effectiveness of accountability is dependent on the proximate institutions, like the *MP*. According to Matthew Tyler, the difficulties faced by the judiciary in holding corrupt officials to account rely on its institutional deficiencies. The system is characterized by an excessive formalism, delay in decision making, and allowance of special protection to public officials (Power and Taylor 2011, 24). Shortcomings like this protect corrupt officials for a longer period of time. Additionally, the criminal code assists accused politicians not only with the right of judiciary secrecy, but also with a myriad of possible instruments of appeal that have led to further procedural delays (M. M. Taylor 2010, 104). In the case of political corruption, the

existence of a special standing in court (*foro especial*), allows the Supreme Federal Tribunal (SFT) to directly judge crimes (M. M. Taylor, *The Federal Judiciary and Electoral Courts* 2011, 173). This procedure should avoid subsequently appeals, but in practice TSF lacks the ability to deal with criminal trials. One recent exception has been the conviction of several high ranking politicians in the 2012 *mensalão* trial. However, top politicians still enjoy virtual immunity. Corruption trials involve criminal sanctions that can only be prosecuted by the *MP*. The interactions with the so called “fourth branch of the government” are essential to understanding incentives behind misconduct.

The MP’s functional autonomy is vital to pursue independent investigations and prosecute wrongdoers. The role of the agency consists of monitoring compliance with the laws that defend the national heritage as well as public and individual interests (Portal Brasil 2014). The external control over police activities and the promotion of public criminal prosecution grants the MP wide powers to fight corruption. While developing its activities, the TCU reports to the MP with evidence of criminal misbehavior. Further developments depend on the efforts and initiatives of each individual prosecutor (M. M. Taylor 2010, 106). This represents an uphill battle when a single prosecutor has to challenge groups of interests deeply rooted within the system. In criminal cases, the quality of the output brought by the MP, relies on police investigation, which instead requires judicial authorization (Arantes 2011). The process continues, since the judiciary is composed of several hierarchical levels that can decide to suspend or delay investigations. Such a conundrum limits the capacity of MP to address political corruption. It is once more in the cross-institutional integration that the corruption escapes punishing.

By examining the deficiencies in Brazil’s intra-state accountability structure, incentives for misconduct within the system have been revealed. Regulations exist to control the illegal activity but the links are still not regularly enforced. Once conviction can be avoided there is space to deviate money and manipulate the regulations of bidding contracts. Furthermore, it is important to briefly note that the popular culture and the context where decisions among institutions are made only help to maintain this status quo in Brazil. As Roberto DaMatta suggests in his book “*O que faz o Brasil, Brasil*”, the majority of Brazilians admit that there exists some flexibility within the legal system (*jeitinho*). This form of social conduct permits the interference of personal relations with the law, preventing its full applicability (DaMatta 1984). In parallel, the political elite believes that it can deal with public resources as if they were private property. It is evident within the concept of horizontal accountability that corruption not only exists in Brazil, but has also become deeply rooted in Brazil *modus operandi*.

Impact of Corruption: Political and Economic

The political cost of corruption influences how citizens perceive transgressions. In this case, the media plays a role in leveraging the dissemination of information. As a consequence, citizens become aware of what their representatives are doing and can judge their actions better. Politically the impacts can be devastating for the credibility of the government. First, corruption undermines regime legitimacy and discredits the popular trust in political institutions (Morris and Blake 2010).

Second, corruption erodes the foundations of rule of law and equality of citizens before the institutions (M. M. Taylor 2010, 94). The cynicism of Brazilian cultural behaviors such as “jeitinho”; if Brazilian representatives are corrupt then citizens will find few incentives to obey the law. As a result, disappointment towards the government escalates, and the credibility of the institutions falls down. Finally, it can be argued that corruption shifts government priorities and this limits its ability to provide essential public goods. Instead of improving education, public transportation or health care for the majority of the people, the government alternatively tends to benefit their clientelistic networks.

In the economic realm, political corruption has severely damaged Brazilian’s macroeconomic stability. The ongoing investigations of corruption in Petrobras have affected confidence and bolstered the negative impacts of corruption (OECD 2015). In August 2015, Moody’s, downgraded Brazil’s government bond rating to Baa3, one level above junk status (Moody’s 2015). Moreover, BBC Brazil reports that Petrobras investments are estimated to represent approximately 2% of Brazil’s GDP. As a consequence of the scandal, Petrobras has decided to reduce more than 30% the volume of investments between 2015 and 2019 impacting a large sphere of the economy (Costas 2015). Apart from diminishing Brazil’s GDP forecast, this corruption scandal leaves less money available in the public accounts to support social projects. Thus, political corruption amplifies the effects on income inequality. In 2013 the income share held by the highest 10% of the population in Brazil was among the top 10 in the world. The upper level class accounted for 41.8% of the total income generated in the economy, whereas the lower class was responsible for nearly 1% (The World Bank 2013). Such a colossal gap between classes imposes the need for better public goods.

Infrastructure

Brazil's government still has a substantive control of the economy in areas such as infrastructure, meaning that it can decide the allocation of significant public resources. Over the years, many decisions over bidding contracts were not based on the best value for money criteria, but instead on noncompetitive tendering. Likewise, corrupt politicians become part of complex schemes to deviate money from public accounts leading to controversial shifts in government priorities. Overall, these factors combined contribute to undermine the quality of infrastructure provided by the government.

The World Economic Forum ranks Brazil 120th out of 144 countries for the quality of its infrastructure (The Economist 2015). Highways, roads, airports, railroads and ports are insufficient and poorly distributed along the country, therefore unable to serve Brazil's development needs. The same problem can be seen regarding other public services, such as hospitals, schools, water and public sanitation, indispensable to assure the basic necessities of Brazilian citizens and their quality of life. This lack of infrastructure is strangling Brazil's growth.

It is mandatory to fix the problem, but massive investments and an efficient use of such resources are even more necessary. Both represent enormous challenges for the fourth largest democracy of the world. First, the government's dramatic budget deficit does not liberate the necessary resources. Secondly, using (actually misusing) resources in an efficient way and guaranteeing that they reach the proper recipients is a major problem for Brazil, precisely due to the high levels of corruption. The magnitude of this issue is demonstrated in a study presented in 2011 by Marcos Fernandes da Silva, at the Fundação Getúlio Vargas. He showed that Brazil had lost R\$40 billion (approximately \$18 billion) to corruption between 2002 and 2008; much of this loss was attributed to the infrastructure sector. Another study by FIESP, a São Paulo-based industrial association, has estimated that with the money lost to corruption, between 2007 and 2010, 124 percent more roads and 525 percent more railways could have been constructed (Ojo and Everhardt 2013). From these findings it can be inferred that by deviating money, corruption severely reduces the quality of infrastructure available.

The promiscuity between politicians, financial entities and contractors is one of the shortcomings that prevents the proper expansion of Brazil's infrastructure (Ojo and Everhardt 2013). There is no better example of such problem than the, already mentioned, "Lava Jato" scandal. It represents the largest investigation ever in Brazil on corruption and money-

laundering, both on the amounts¹, economic impact², entities & persons³ involved, as well as public resources allocated to the investigation⁴.

The scheme was very well organized: contractors and other service suppliers, acting as a cartel, arranged between themselves how to split the contracts to be awarded by Petrobras and for that they were paying bribes to Petrobras officers. Subsequently, the contracts were overpriced and overcharged harming the interest of the company and the State. The bribe amounts were circulated through financial intermediaries and later hand in to politicians and public officials. In the end the scheme was benefiting political parties – PT⁵ and PMDB - responsible for the appointment of certain Petrobras Directors that were implementing the scheme at the level of the Company.

The investigation showed the involvement of several of the major contractors of the country acting in connection with financial institutions⁶, officials and politicians⁷. Meanwhile, the SFT has opened a criminal investigation against nearly 50 politicians with privileges resulting from their functions. The MP estimates that approximately R\$2.1 billion were deviated from Petrobras accounts, but this is certainly the tip of the iceberg (Folha de São Paulo 2015). Since Petrobras is partly a state owned company, its losses will have to be supported by the Brazilian tax payer. A problematic Petrobras means that fewer resources will be available to promote schools, hospitals or improve housing.

In 2012, an audit report ordered by the TCU identified eighteen irregularities among “Comprasnet”, the bidding portal used by the federal government to acquire goods and services for the society (Tribunal de Contas da União 2012). This portal is at the centre of Brazil’s bidding system. If corruption is part of the equation, decisions change tack and the provision of public goods are not defined by neutral criteria. Among the main deficiencies identified were contracts signed by the federal government with companies owned by parliamentary members, which is prohibited by the constitution. Indeed, the lack of internal control enabled the occurrence of irregularities during the bidding process. From this case, one may argue that corrupt politicians

¹ in 2014 accounts, Petrobras estimated a loss of 6.1 billion Reais caused by corruption

² according to the consultants Tendências and GO Associados – December 02, 2015 -, without Lava Jato Brazilian recession could be three times lower, having an impact of 2,5% in GDP

³ politicians, company directors, financial entities, contractors

⁴ more than 20 public prosecutors – Procuradores da República – directing the investigation

⁵ Illustrating how far this process may go, on December 03, 2015, the MP investigating Lula da Silva required access to Lava Jato data

⁶ On November 25, 2015, a very important person of the Brazil’ financial institutions – André Esteves, BTG Pactual’s CEO – was arrested, accused of obstructing the investigation

⁷ Délcio Amaral. Leader of the PT in the Senate, was arrested , on the same day and for the same motives as André Esteves,

in Brazil have had control over bidding contracts that allocate infrastructure spending. They have found ways to bypass competition and therefore increase their personal revenues at the expense of the State.

For different reasons, another very important example of the magnitude of the corruption in Brazil and the challenge of combating it, was Brazil's Football World Cup held in 2014. The government decided to build and refurbish football stadiums. And the story has a sense of déjà vu: as an example, the costs of building Brasilia stadium almost tripled reaching approximately 900 million dollars. Why? Well, overpricing and overcharging again. In this case, a very close link was identified between the contractors and politicians granting and supervising works, in particular regarding large sums donated by such construction companies to political campaigns.⁸ But what was new and remarkable was the reaction of the Brazilian citizens, even more as football is a national passion. During the summer of 2014, many Brazilians reacted and organized national wide protests against the waste of money (used and misused) when they had such gargantuan needs in Education and Healthcare. This was a game changer, as the population has reacted and called for the minimum satisfaction of their basic needs. They have openly demanded that their money should have been properly spent and on the proper spheres, such as in funding schools and hospitals.

Healthcare and Educational infrastructure are, precisely, the main areas of shifting Government priorities, allocation and misuse of public funds. The infrastructure that support them comprise a great number of contracts of small and medium size. Such a complexity creates an increasing difficulty for the State in terms of supervision and control over the process. As a result, overpricing, overcharging, delays in the works affect the overall quality of the infrastructure. In the worst case scenario, the facilities may never be built. Finally, according to FIESP, without the effects of corruption the Government's investment in essential public goods would have been much higher. For instance, in education, the number of students that had enrolled in the public elementary school would have jumped from 34.5 million to 51 million. In healthcare system the number of beds could have increased by 89%, representing an increment of 325.000 beds (Sindicato dos Servidores do Poder Judiciário Federal do Estado de Mato Grosso 2011). Resolving the problem of corruption will require time, but its benefits for the wellbeing of the population are clear.

⁸ Andrade Gutierrez was again involved in the game.

Conclusion

Political corruption in Brazil constitutes an endemic phenomenon, based on disguised relations between politicians and private interests, lack of transparency and heavy bureaucracy. Additionally, the complexity of the Brazilian laws and the lack of coordination between institutions of accountability allow corruption to enter in the system. By using a wide range of examples this essay has showed that corruption specifically limits the government's ability to provide vital infrastructure to Brazil's development. The deviation of public funds, the shift in government priorities and misleading results in bidding contracts bedevil the quality of Brazilian's infrastructures. However, the recent evolution in Brazil is promising. Several laws were recently enacted, with emphasis on the Clean Companies Act, which aims to improve the legal framework by increasing the demand for business integrity. Initiatives such as the electronic platform "Portal da Transparência" (Transparency Portal) and "Portal de Combate à Corrupção" (Combating Corruption Portal) bolster the levels of transparency. However, involving society in denouncing corruption may represent the challenge of the future, requiring a long-term approach. Brazilians need to increase their commitment to combating corruption and cease to be tolerant of it. This requires a consistent effort with regard to education, precisely one of the areas more negatively affected by political corruption. Nevertheless, the example of people's reaction to the 2014 World Cup corruption episode is a sign of hope. Many things have to be done to vanquish political corruption and improve the quality of infrastructure provided, but Brazil seems to be moving in the right direction.

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