Douglass North and Brazil's "Car Wash" Scandal

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Douglass North, winner of the 1993 Nobel Prize in economics, passed away late last year at the age of 95. North was noted for advancing the theory that institutions—which he referred to as a society's "rules of the game"—are critical for the functioning of the economy. His defence of the fortification of mechanisms for upholding contracts and property laws is now well known. Not as famous, however, is his equally insightful theory of the dynamics of institutional evolution in societies. This lesser known line of thinking allows us to engage in useful reflection about the current imbroglios gripping Brazil's bustling democracy.

North's reflections on institutional evolution hold "social order" as the foundational concept. Formulated late in his career, his considerations were consolidated in his last major book, Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History, published in 2009 in co-authorship with Barry Weingast and John Wallis. In a country with a "limited access" social order, the political system manipulates the economic system so that elites can rent-seek and block access by non-elites to economic opportunity. In such countries, appearances can be deceiving. Formally speaking, there may be a tripartite distribution of power, professional state bureaucracies, and elections by private ballot. The restrictions to access, however, are largely informal, and arise because the dominant structure in society is personal interaction rather than impersonal laws. In these settings, stability is achieved through the collaboration and exchange of favours among the political elite and the economic plutocracy. Corruption small and large, both inside and outside bureaucracy, is pervasive. When everyone has an implicit glass ceiling, cooperation is better than competition.

By contrast, in a country with an “open access” social order the basic dynamics of wealth creation and the allocation of power are not based on exchange of favours, but on political opposition and the race to create innovations that generate economic progress. No group is able to impose its will over the others unilaterally, so a balance of political power prevents state appropriation by any one group. Even if each group constantly attempts to take control over the public sphere, none of them is strong enough to do so in a decisive manner. The groups monitor each other, and when conflict emerges the impasse is overcome not by exchanging new privileges within the elite but by creating new impersonal rules. Existing institutions and beliefs prevent the emergence of violence and create stability, paving the way for the consolidation of the rule of law.

This is where North's theory intersects with the striking facts that have now become public through the “Lava Jato” (literally, Car Wash) scandal and related investigations ongoing in Brazil. In 2014, in the course of an ordinary police investigation into money laundering through a chain of gas stations and laundries, the Federal Police came across evidence of multi-billion dollar corruption at the state-controlled oil giant, Petrobras. Evidence has emerged of a regimented scheme of institutionalised corruption and money laundering involving high-level politicians, Petrobras officers, and businessmen from some of Brazil’s largest private companies who conspired for years to supply Petrobras with overpriced goods and services. The alleged kickbacks from Petrobras were used to finance political campaigns and to bribe government officials.

So far, more than 50 politicians have been implicated, including former President Lula da Silva, the president of the Brazilian Senate, the president of the Chamber of Deputies, and the treasurer of the ruling Workers’ Party (PT). In the midst of an economic downturn, this corruption scandal has snowballed and paralysed the Brazilian political system, also blocking the (as yet timid) attempts by President Dilma Rousseff to address the country’s growing budgetary deficit. Even if impeachment procedures recently initiated in Congress against President Rousseff eventually fail, social unrest and political fatigue strongly suggest that this fourth consecutive presidential term of office of the PT in power will be the last.

So a new party will come to power. What then? There are at least two possibilities. The first is pessimistic: everything will return to the way it has always been. Any eventual political changes will be cosmetic and limited, because in a country like Brazil, the more things change, the more they remain the same. Decades ago, dictatorship was to be blamed; now it is the election cycles. Thanks to the electoral cycles of reinstated democracy, there is an urgency to steal more, as election campaigns are expensive; and to steal more quickly, because the timeframe to fill the coffers is tighter. Everything is counterintuitive: greater risk of police detection and legal consequences will translate into bigger bribes, driving good men away from politics and instead attracting opportunists. Perhaps the result then in Brazil would be a repeat of the Italian Operation Clean Hands from some years back. In Italy, a whole political class was liquidated, but it seems that the rules of the game have not changed and everything has returned to the status quo. In short, nothing will improve for us in Brazil: our politics are doomed to be based on privilege; our society, on backwardness; our democracy, on illusion.

The alternative reading is more hopeful, and a Northian perspective helps understand why. Democracy–which is first and foremost a competition for power through votes – will work as intended. The road will be long, but a decisive step will have been taken if the race for power helps reduce, rather than expand, corruption. Despite the impositions of the electoral cycles and the need to finance election campaigns, crime typically does not pay when state organisations work tolerably well. Those in power today will no longer be there tomorrow, so they must take heed and walk straight and narrow–not for fear of political persecution but out of fear of the application of the rule of law. Therefore, the logic goes, the risks of legal action and punishment will gradually render the practice of corruption not only immoral (which it has always been), but also contrary to the self-interest of those in power. If this were to occur, the political culture would change, and then, perhaps with some luck, it would be possible to rein in populism and reform the Republic step by step, re-setting the existing rules based on a spirit of dialogue, compromise and a vision of a more prosperous future.

North recognised that institutional changes do not necessarily come quickly, may not be successful, and are subject to setbacks of all kinds. But if there is a possible optimistic reading amid the current havoc in Brazil, it is that operations such as Car Wash are part of a process of institutional advancement and a growing openness of the social order. If all goes well, then the current political impasse, rising unemployment, brutal economic recession and increasing poverty will in the future be recast as the bitter price that Brazilian society had to pay in its path toward the establishment of the rule of law. To be sure, no society can be reformed only by police action, and whether the desired institutional improvements will in fact ensue from the current scandal is yet unclear. But in a country with as much potential as Brazil there is a lot to be gained by implementing reforms that will pave the way for prosperity. The size of our challenges suggests caution, but at this point a little hope might do us Brazilians good.

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