TELECOMMUNICATIONS
GETTING READY FOR THE NEXT WAVE OF TECHNOLOGY

INTERVIEW

Cesar Borges de Souza
Vice-president of Caramuru Alimentos
Food processing industry

VIEWPOINT: The debate on education and development
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Viewpoint
The debate on education and development
In recent years the left and the right seem to have traded places, with the right emphasizing education and the left industrial development. Today everybody agrees that education is vital, both quantitatively and qualitatively, to national economic development and reduction of income inequalities. Education has been a government priority since the mid-1990s. Lately, the idea has gained strength that economic development depends fundamentally on issues directly related to industry and business organization, and government intervention is warranted. We need to know which way the new administration will lead the country during years of “lean cows” and difficult choices. (page 4)

Cover story
Getting ready for the next wave of technology
Technological convergence allows fixed and mobile telephone operators to lower costs, extend the licenses of all types of services, and package together products that were previously delivered by separate modes. Mergers, acquisitions, foreign investments, and a new regulatory structure are all among the changes taking place in the Brazilian telecoms sector. Liliana Lavoratti explains what is happening. (page 6)

Interview
Strong in logistics: Caramuru Alimentos
Company Vice President Cesar Borges de Souza explains to Klaus Kleber how Caramuru Alimentos has risen to the challenge of delivering its raw materials and products across vast areas, and how it is staking out some special niches, especially in non-genetically-modified foods. The company is not as affected by the overvaluation of the real as other exporters, and actually benefits from some aspects of fiscal policy. (page 14)

International
Monetary and fiscal follies
In the U.S., experts are arguing stridently about monetary policy and the budget deficit, but few have noticed that in what seem to be separate arguments about monetary and fiscal policy, the arguments are actually the same. Distinguished economic scholar Barry Eichengreen elucidates the arguments and analyzes what really needs to be done. (page 18)

Foreign trade
How services contribute to the current account deficit
Lia Valls Pereira explains that Brazil’s current account deficit for the year to date is already higher than it was for the whole of last year. The trade balance is the main determinant of the current account balance. Now that information technologies have transformed trade in services, she clarifies why keeping an eye on trade in services should be an integral part of foreign trade policy of Brazil. (page 21)
In the last decade, since the telecommunications sector in Brazil was privatized, as the cover story explains, it has undergone sweeping changes. Now, as in the rest of the world, a second wave of changes is arriving. The question now is ensure broadband access for the majority of the population. This is what is guiding the actions of operators, suppliers, regulators, and the government. The next step will be how technological convergence will bring TV and broadband together to transport, store, and redistribute sound, video, voice and data.

Already fixed and mobile telephone operators are merging to lower costs and optimize resources. Recently, the Spanish company, Telefónica, has purchased 100% of the Vivo company. Mexican businessman Carlos Slim, owner of Telmex, has shown interest in becoming sole owner of Brazil’s Net Serviços company. These developments give rise to large business groups, similar to what happening throughout Latin America, where the prevailing two international companies are Spain’s Telefónica and Mexico’s Telmex.

In Brazil there are actually three groups because the national company, Oi, has been strengthened by a 23% investment by Portugal Telecom. But how smaller companies will fare is not clear. “They may be purchased by large companies or maintain separate operations in specific market niches,” says economist Marcio Couto of the Brazilian Institute of Economics, a former executive of the National Telecommunications Agency and director of Embratel.

Lower costs and solid companies seem to be the prospects for the telecom sector. Between 2000 and the first half of 2010, the prices of communications services in Brazil increased above inflation by 1.5%, while the United States and European Union countries registered declines of 32% and 36%. One explanation for this is due to privatization. Because the sector was in precarious condition, there was a need for heavy investments to improve the networks. Most of the investments had to be funded by higher prices.
The debate on education and development

For the general public, the left is characterized by concern for the poor and social policies, and the right by the defense of market forces and individual success. It is curious, then, that at the moment the so-called progressives are far more focused on issues of industrial development, while conservatives emphasize social and educational themes. In the 1950s, Eugenio Gudin, the founding father of Brazilian economic liberalism, wrote that “the most detrimental of all bottlenecks is education, which should be included with high priority in the economic development program.” The left and nationalists put to one side social infrastructure and the quality of human capital, and focused entirely on the challenge of industrialization. Celso Furtado and Roberto Simonsen were the principal proponents of this view. In the 1970s, economist Carlos Geraldo Langoni, a liberal economist and former governor of the central bank (1980-83), produced a seminal work indicating that educational inequality was a key factor in explaining income inequality and the economic backwardness of Brazil. At the time his study was heavily criticized by leftist economists, and Langoni’s warning unfortunately had little influence on public policy. It was not until the 1990s that studies using large databases, such as those conducted by Ricardo Paes de Barros, showed in hindsight that Langoni was right.

Today everybody agrees that education is vital, both quantitatively and qualitatively, to national economic development and reduction of income inequalities. Education has been a government priority since the mid-1990s. The administrations of both Fernando Henrique Cardoso (FHC) and Luiz Inacio Lula da Silva (Lula) have made notable progress in this area, especially in primary education, by placing all Brazilian children in school for up to 15 years, and building a credible system for measuring school performance. But despite undeniable progress in education, Brazilian children still do very poorly in international tests of education quality. Lately, the idea has gained strength that economic development depends fundamentally on issues directly related to industry and business organization, and government intervention is warranted. In spite of the similarities to the FHC in terms of macroeconomic policy, Lula’s administration is again taking up, in the final years of his mandate, the stance of national developmentalism. In this view, the key to national development is the formation of large business groups,
either supported by the National Bank for Economic and Social Development (BNDES) or directly managed by the government. Regardless of the current direction of the ideological winds, a question remains: Should not the left worry more about the emancipation of the dispossessed poor, which can only be achieved by education and social policies? One difference in the approach to economic development is that the right prioritizes the supply and quality of factors of production (skilled labor force), while the left emphasizes the productive structure (industrial policy). Another divergence between the two views is about the role of the international economy, of which Brazil is a part. The left gives great importance to areas of friction and dispute between countries: national economies develop by overcoming the limitations imposed by an international system that protects rich countries and hinders the rise of emerging economies. Conservatives consider that underdevelopment is due more to the internal failures of national economies that fail to promote growth; we must correct problems such as the poor quality of education that which have little connection with the country’s international relations. The spectacular Asian development in recent decades does not resolve the discussion. On the one hand, China and the Asian tigers (Hong Kong, Singapore, South Korea, and Taiwan) in varying degrees had very aggressive industrial policies. On the other hand, all these countries have made or are making huge leaps in education and dissemination of technological skills. On these issues, Lula’s administration has been firing in all directions. He has both invested in education and carried out social policies but in the final years of his administration, there has been a resurgence of national developmentalism. The success of Lula in both reviving growth and reducing income inequality does not necessarily mean that all his policies are right. As in the case of East Asia, the two sides of the argument maintain their positions. The debate continues, and we need to know which way the new administration will lead the country during years of “lean cows” and difficult choices.

Today everybody agrees that education is vital, both quantitatively and qualitatively, to national economic development and reduction of income inequalities. Education has been a government priority since the mid-1990s.
The telecommunications industry, which has undergone a revolution over the past 12 years, is preparing for a second wave of profound changes as broadband access is spread to the majority of the population.

The current trend of packaging together services that previously required independent equipment, communication channels, protocols, and standards has led participants in this sector to explore combining a variety of products, as in triple (fixed phone, broadband, and pay TV) and quadruple (plus mobile telephony) packages.

Technological convergence allows fixed and mobile operators to lower costs and extend the licenses of all types of services. This has happened with recent acquisitions and mergers: Telefónica purchased 100% of Vivo, and the Mexican
businessman Carlos Slim has shown interest in becoming the sole owner of Brazil’s NET Serviços, the largest multiservice cable operator in Latin America. Slim, who owns Telmex, which in turn owns Embratel, Claro, and part of NET companies, has also announced that the group intends to buy a 50% stake in cable TV operator Globo group as soon as the law permits.

Concentration
In Latin America generally, two international companies are prevailing, Spain’s Telefónica and Mexico’s Telmex. In Brazil, they are joined by Oi, a national company of which 23% is held by Portugal Telecom. What will happen to smaller companies is not clear. “They may be purchased by large companies or maintain separate operations in specific market niches,” says economist Marcio Couto of the Brazilian Institute of Economics, who is a former executive of the National Telecommunications Agency and Embratel. He is referring to GVT, the French group Vivendi, and Tim; the regional CTBC in São Paulo state and Sercomtel in Paraná state; and Nextel, a provider of personal mobile radio service that intends to expand its operations in 3G. But, Couto notes, “Everything indicates that the market is moving toward consolidation of three major groups, organized around the demands and needs of the consumer.”

Giving the vast majority of Brazilians access to the virtual world is no longer merely their personal desire; it is public policy. Couto believes this policy goal is the frontier the telecom companies are now exploring. Of the 50 million households in Brazil, only 11 million are served by broadband; fixed telephony reaches 40 million homes.

Different countries have adopted different ways of achieving that goal. In Brazil, a key issue is whether the regulatory framework is responsive to the changes in technology. Couto believes that Brazilian law is sufficiently broad, adding that “One issue is the speed of broadband. As demand grows, the government must establish the instrument to be adopted to accelerate expansion of this service.”

Another important issue is the prospect of more cable TV competition. This year Congress is expected to approve Draft Law 116 of 2010, which allows phone operators to enter this segment and increased participation by foreign capital. One of the most debated points is the requirement that television programs have 40% national content. The idea is to avoid a possible scenario that a major group like Telmex broadcasts in Brazil only content from Mexico.
Advances in communications led the government to revive Telebrás with the mission of carrying out the National Broadband Plan.

There are concerns that the concentration that has occurred in television networks will be replicated for cable: the market is basically dominated by two companies. Today, when the average speed of the Internet in Brazil is only 1 megabyte, according to the Brazilian Institute of Consumer Protection (IDEC), transmission of films by computer and phone is precarious. But Couto thinks “it’s only a matter of time and depends largely on improving infrastructure.”

Resurrection
The progress in communications has led the government of President Luiz Inacio Lula da Silva to revive the government telecom company Telebrás, which has been inoperative since telecoms were privatized in 1998, and mandate that it carry out the National Broadband Plan in order to stimulate service access and competition.

Regardless of how much Telebrás intervenes in the broadband segment, the fact is that the expansion of telecommunications is directly linked to its growing uses, for example, connecting thousands of schools; managing public resources better (electronic government); improving public safety (electronic surveillance); and facilitating the exchange of information between hospitals, even with long-distance surgical interventions through high-resolution images.

“The changes underway will establish significant areas of performance unprecedented for a variety of companies, such as providers and generators of content specifically for mobile phones”, notes Aluízio Byrro, chairman for Latin America of NokiaSiemens Networks, the second largest supplier of telecom equipment, software, and infrastructure services in the world.

The prospects are so promising that forthcoming public and private investments are estimated at about R$70 billion (US$40 billion). “We will use the 21,000 km of optic fiber cable that the country already has and we hope to reach 31,000 kilometers in 2014,” says Rogerio Santanna, Telebrás president.

The contribution of telecoms to gross fixed capital formation shows...
the importance of the sector for the Brazilian economy. From 2000 to 2008, fixed telephony invested R$70 billion and mobile R$39 billion, the auto industry invested R$52 billion, steel R$29 billion, and consumer electronics R$26 billion. Telecom gross revenue of telecommunications rose from R$31 billion in 1998, the year of privatization, to R$181 billion in 2009.

Groups
Three private telecoms companies (Telefónica, Telmex, and Oi) now have a national presence, and a few smaller companies (e.g., Tim and GVT) occupy niche markets. The government role through Telebrás is not very clear. Two services, fixed and mobile telephone, are now considered mature, and access to broadband Internet and cable TV are following the same path.

Frederico Turola, a partner in Pezco Consultoria Internacional and professor at FGV São Paulo, says that the configuration of the sector derives from the regulatory environment created in the 1990s: “The result was a major advance in both the dissemination of use and lower prices, leading to an expansion of supply and access to telecommunications services,” but “this very positive development stopped in the current decade.”

Privatization was part of a set of reforms undertaken through a constitutional amendment designed by Sergio Motta, Minister of Communications during the first government of Fernando Henrique Cardoso (1995-1999), and then by the General Telecommunications Law (number 9,472 of 1997). Creation of the National Telecommunications Agency (Anatel) completed the promotion of competition, universal access, and quality.

Consolidation
Until 2003, the General Plan for Universal Access ensured increased coverage of fixed telephone service for the 25 million potential users who waited months to get a line and paid very high prices. Mobile telephony has now surged past fixed telephony. The stagnation of fixed is partly attributable to the fact that, as in the rest of the world,
After working to attract investment and improve infrastructure in the last 10 years, the National Telecommunications Agency (Anatel) is now focusing on quality and increased competitiveness in telecommunication services, says Simone Scholze, Executive Superintendent, in order “to achieve improved quality of services, customer service and lower prices.”

This new phase will be based on the General Plan of Targets and Competition (PGMC) within the General Plan to Update Regulations (PGR), approved in October 2008. The PGMC defines measures companies have to follow. A pilot project was tested when Anatel approved the purchase by Oi of Brazil’s Telecom. The merger of the two companies was approved because Oi committed to invest in research and development (R&D) for 10 years: Through 2009–2019 the operator will allocate R$60 million to R$70 million a year for this purpose. These costs correspond to 100% of the amount Oi collected from the Fund for Technological Development of Telecommunications (Funtel).

These investments are to be made in partnership with centers of excellence and research institutions. Oi is also obliged to provide transmission infrastructure to the national network of public research related to the Ministry of Science and Technology.

Scholze considers one of the most important PMGC initiatives to be encouraging the national telecommunications industry. Oi and eventually all operators will be required to purchase a certain amount of equipment and systems from national companies (nationalization index). The index is part of a package of new rules that the board of Anatel will be analyzing in coming weeks. “It is now appropriate to generate a market for innovation, organizing demand from telecom operators,” she says, pointing out that since privatization the profile of Brazilian investment in R&D has undergone profound changes. In the 1970s and 1980s, the Center for Research and Development (CPqD) ruled the area. Having two-thirds of sales in the Brazilian market, CPqD has come to hold nearly 350 telecommunications patents.

“But by 2000,” Scholze says, “we saw a collapse of the government’s investment capacity, which in turn led to jamming of the telecommunications network and created pent-up demand of 25 million potential users.” She said with privatization there was a decline of innovation capacity. “With foreign investment, corporations chose to develop innovations at their headquarters, as they had global distribution and coverage. Thus, suppliers in Brazil lost market share.” Twelve years later, there are no mechanisms to promote domestic R&D, as CpqD did. That’s what we are now doing with PGMC.”

However, despite these efforts, fixed telephony has not gained the same traction as mobile phones. One detail is unique in Brazil: of 179.1 million cellular phones in March 2010, according to Telebrasil, 82.5% were prepaid. Another characteristic: free or reduced rates on calls between customers of the same operator encourage cell phone use.

Despite poor performance in recent years, fixed telephony has gained force as the Internet has expanded because it supports the transmission of data via broadband. Users of fixed telephony represent a significant source of revenue for operators because of basic subscription fees and the fact that past investments are already amortized.

Experts estimate that by the end of this year Brazil will have about 250 million handsets, of which 200 million will be mobile phones. This is equivalent to more than one phone per inhabitant, compared with less than 5 million before privatization.

Although a growing number of Brazilians have more than one line, the relatively low usage of mobile telephony suggests the continuing potential of this market. As of March 2010, the monthly average amount of minutes used per mobile phone was only 103 minutes in Brazil, 120 to 130 minutes in Latin America generally, 400 minutes in India, and 800 minutes in the United States. One factor
inhibiting use of mobile phones is the high tax, about 40%.

**Competition**

Was competition promoted? For Byrro of NokiaSiemens, the answer is yes, especially in mobile telephony, with four carriers and space for another large operator. According to Telebrasil, 79% of mobile users can be served by four to five providers, although in fixed telephony the very high investment needed for a new operator to enter hinders competition, Byrro says. The real competition for fixed telephony is mobile.

For Paulo Mattos, a director of Oi, “It’s a mistake to speak of the telecommunications market as if it were one. In Brazil, the dynamic is unique because part of the market is comparable to the rich countries, where there are two to five competitors, high income and population density, and therefore investment. The other part of the market exhibits a different profile: few consumers and low income.” Mattos thus sees the problem today as not one of more competition but of adequate financial support to increase consumption by the low-income population.

According to Turola, the idea was that Anatel would foster competition, for example, by granting more licenses for the use of the spectrum for mobile and pay TV. However, Anatel — designed to be an independent agency and devoted primarily to universal access and competition — lost its way when it became driven more by political considerations in the mid-2000s. This was what happened when it approved the acquisition of Brazil Telecom by Oi and the government changed the law to allow the acquisition.

Rogério Takayanagi, Chief Marketing Officer of TIM Brazil, wonders what consumers will gain from the reorganization of telecommunications. He says, “We do not believe there will be a significant gain for users. Concentration will reduce the aggressiveness of competition. As companies try to offer ‘combos’ of services to reduce their loss of customers, they will increase the average amount paid by consumers.”

**Challenges**

In fixed telephony, Couto says, operators will need to increase their capacity and the speed of broadband transmission, which requires large investments. The trend is to build a fiber optic network, as in Japan and England. Byrro believes, “The best policy would be a public subsidy to companies to make broadband reach all corners of the country, but the government prefers to build its own network.”

The government says it will use existing infrastructure, such as

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**PREPAID MOBILE PHONES**

<table>
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<th>Year</th>
<th>Percent of Total Mobile Phones</th>
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<tbody>
<tr>
<td>1998</td>
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<td>1999</td>
<td>38.3%</td>
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<td>2000</td>
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<td>2001</td>
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<td>2002</td>
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<td>2003</td>
<td>78.2%</td>
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<td>2004</td>
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<td>2005</td>
<td>80.8%</td>
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<td>2006</td>
<td>80.6%</td>
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<td>2007</td>
<td>80.7%</td>
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<td>2008</td>
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<tr>
<td>2009</td>
<td>82.5%</td>
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<td>2010</td>
<td>82.5% (1st Quarter)</td>
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Source: Anatel.
Between 2000 and the first half of 2010, prices of communications services in Brazil rose faster than inflation by 1.5%, while the United States registered a decline of 31.7% and European Union countries of 35.5%, according to the study by Fernanda Lima, partner of Pezco Pesquisa e Consultoria.

There are a number of reasons for this gap. According to economist André Braz of IBRE, part of the difference is due to the privatization process. “The telecom sector was in precarious condition and required large investments. Most were funded by higher prices,” he explains. The cost of fixed residential telephony rose 142% from 1998 to July this year.

According to Braz, the tariff adjustment is protected from inflation by indexation. Currently, fixed telephony lines are adjusted by the Telephone Service Index (IST). The formula for calculating the index transfers part of company profits to the consumer by lowering the tariff.

The government’s expectation is that investors in small towns will be willing to put in resources to link urban districts to the national system. “The government is proposing to help in the more difficult task of linking the entire country. But the government will participate in the development of the network to bring broadband to homes only if there are no willing partners to do it,” says Byrro.

Other challenges require adjustments in the legislation without changing the current regulatory framework. Besides reducing the tax burden, the management capacity of concessions in the spectrum is a major top concern of businesses.
This new study describes the recent evolution of income distribution, poverty with a special focus on the so called new middle class, its financial possibilities, access to consumer goods, assets and aspirations. It extends and translates our recent research on the topic, discussing the sustainability. It processed recently released microdata from household surveys such as PNAD 2009 (National Household Sample Survey), and PME (Monthly Employment Survey) up to July 2010. The results are quite surprising. The best moment in terms of income based social indicators is right now.

The research’s website www.fgv.br/cps/nmc offers an interactive data set with a vast array of data which allow you to explore how, where, when and why income distribution is changing in the country.
**INTERVIEW**

The Brazilian Economy — What were Caramuru Alimentos revenues last year and what is its market share?

Cesar Borges de Souza — Our turnover last year was R$2.2 billion (US$1.3 billion). This confirms the company’s position as the largest national company processing soybeans, corn, sunflower, and canola. Founded in 1964, Caramuru Alimentos is a family business, but it has professional management. Besides industrial units in Itumbiara, São Simão, and Ipameri in Goiás state, it also operates a plant in Apucarana in Paraná state and rents a plant for refining soybean oil in Fortaleza, in Ceará state. The fact that we also produce non-genetically-modified grains adds value to our products, especially in foreign markets.

What is the company’s work force today?

Altogether, we generate 3,468 direct jobs, and the indirect jobs number in the thousands, including suppliers of raw materials, transportation, port handling, trade, and other activities.

How much of the company’s revenue comes from exports, and what are its main markets?

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**Klaus Kleber, São Paulo**

With suppliers whose factories are far from the coast, Caramuru Alimentos, the largest national processor of soybeans, corn, sunflower, and canola, has to go a long way to get its products abroad. “Logistics is one of our strengths, export of non-genetically-modified foods is another,” says Cesar Borges de Souza, vice president of the group. The factory’s products are transported from São Simão, in southern Goiás state, by water (Paranába-Parana-Tiete) to Pederneiras in São Paulo state, then by rail to Santos city on the coast. Soybeans from Mato Grosso state go by truck to Uberlandia in Minas Gerais state, where they are transferred to the Ferrovia Centro Atlantica railway to reach the port of Tubarão, on the coast of Espírito Santo state. Unlike other exporters, Caramuru is not concerned about the overvaluation of the Real currency. “What has much more impact than the exchange rate is fiscal policy, which prioritizes the shipment of raw material, in this case soybeans, at the expense of industrial products,” says Borges de Souza.
Our exports totaled US$462 million last year. Despite the shrinkage in the external market, we were able to increase our export earnings by US$4 million. Foreign sales accounted for 49% of our total revenue in 2009. This year the forecast is for the value of our exports to increase 5% to 10%, mainly because of better prices for soybeans.

What are the most important foreign markets for non-GM crops?
They are mainly the Northern European countries, such as Germany, Britain, and the Nordics. We also have demand from central European countries like Austria and Switzerland.

How has the company performed in the domestic market?
Caramuru Alimentos strengthened its position, benefiting particularly from the effort to produce biodiesel and launch new product lines, such as white beans and peas. These products are marketed under our traditional Sinhá brand, along with corn and soybeans; corn, sunflower, and canola oils; and corn flour, corn meal, popcorn, cake mixes, and couscous. Today, the Sinhá brand represents 25% to 30% of the Caramuru group’s business. We supply the Southeast, Northeast, and South. We also provide raw material for the food and drink industries.

What is the company currently doing in the area of biodiesel?
Our production of biodiesel from soybeans reached 103,000 tons in 2009. We are investing R$54 million (US$31 million) in a new biodiesel plant in Ipameri city, Goias state. In a few months it will gear up to annually produce 110,000 tons of biodiesel and 11,000 tons of glycerin. We are investing another R$30 million (US$17 million) to expand the plants for processing biodiesel and soybeans in São Simão, also in Goias state. Thus, biodiesel capacity will reach 187,000 tons.

Caramuru has a niche market, which is non-GM soy. How are the non-GM exports certified?
The process is done by two internationally recognized certification companies, which check all phases of production: planting, harvesting, transportation, loading ships, etc. This process is known as Hard IP (Identity Preserved). We also have ISO 9001, ISO 14001 certification, and guarantee that production of these products is NO GMO (Non-Genetic Modified).

What is the difference in international prices for GM soy and non-GM soy?
European and Asian markets give a higher value to non-GM products, paying premiums depending on the availability of raw materials and demand for the product. Currently, for example, producers of non-GM soy receive R$1.50 to R$2.00 more per bag.

Do you export other non-GM products?
Besides soybeans, Caramuru exports non-GM soybean meal for animal feed, soy oil, and soy lecithin. Because it is a

Our exports totaled US$462 million last year. This year the forecast is for the value of our exports to increase 5% to 10%
natural product, for instance, non-GM soy lecithin is used to make cosmetics and pharmaceutical products and in the dietary and food industry as an emulsifier for pasta, chocolates, breads, etc.

With production units located so far away from ports, what do you do to reduce the cost of transportation?
Since we started to expand sales in foreign markets, this has always been one of our main concerns. We made an agreement with Ferronorte railway, which links Mato Grosso do Sul with the port of Santos to put on track five locomotives and 150 wagons, which we bought to meet the increasing volumes of goods requiring transportation. For this we invested US$10 million.

The company is also known for using water transportation, which is not so common in Brazil, although it is cheaper. How much was invested in this type of transportation?
Caramuru invested about R$100 million (US$57 million) in a project to integrate road-rail-waterway transport; today it is considered a benchmark in logistics.

Logistica company to the port of Santos, where Caramuru operates two export terminals.

We hear constant complaints from exporters about the overvaluation of the real. Has this factor affected your exports significantly? Nobody denies that the real is overvalued and harms sales of manufactured goods. But the effect is attenuated in agroindustrial activities, since imported fertilizers, which account for a substantial part of the cost, are bought at a lower rate. Equally or more important than the exchange rate is tax policy, which prioritizes the shipment of raw material, in this case soybeans, at the expense of industrialized products.

Has Caramuru faced constraints or barriers in foreign markets?
Yes, like other companies in Brazil that export soybeans and derivatives, our business is affected by tariff barriers, especially the practices of China and the United States. We face so-called “sanitary” embargoes and other protectionist practices.

What other investment plans does Caramuru Alimentos have?
We are concentrating on biodiesel production. Caramuru Alimentos is investing R$105 million (US$93 million) in the expansion of its processing complex in Goias, and there are three projects at the Itumbiara plant in which we are investing a total of R$21 million (US$12 million). The first is setting up a production unit for soy-based beverages, with a capacity of 38 million liters...
per year. The second is a packaging facility with a capacity of 254 million pieces a year. And the third will allow a 23% increase in the capacity of the corn products plant from 215,000 today tons to 263,000 tons.

In general, how far do you think Brazil can raise its food exports, considering increasing demand from China, India, and other countries? The prospects for food exports to China and India are promising, but it is difficult to quantify the growth potential, mainly because of protectionist practices, especially in China. Brazil, however, is leading the production and marketing of safe, non-GM products.

Is the company considering entering the capital markets? Yes, we are considering it, over the long term. We want to do it in an orderly manner. We are already doing our homework, step by step. The company undergoes quarterly audits, and we are preparing ourselves internally to be a publicly traded company.

Opportunities for food exports to China and India are promising, but it is difficult to quantify the growth potential, mainly because of protectionist practices, especially in China.
Monetary and fiscal follies

Barry Eichengreen

In the United States the approach of the November midterm elections has combined with worries about a double-dip recession to rekindle the hot debate over monetary and fiscal policies. Unfortunately, while both the election and the danger of a second dip are drawing closer, a coherent resolution of the policy debate is not.

What no one seems to have noticed is that while the protagonists in these two debates over Fed policy and the budget deficit are different, their arguments are exactly the same.

On one side of the debate over monetary policy are those like James Bullard, president of the St. Louis Fed who are wary of an economic slowdown. They argue that if this danger deepens, the Federal Open Market Committee may have to follow up on the decision at its August meeting not to let the Fed’s balance sheet shrink as its holdings of mortgage-backed securities mature with another round of quantitative easing. Interest rates may have to remain low for a long time to support an economy at risk of lapsing into deflation. One now hears predictions that the Fed will not begin raising rates until 2011 or even 2012.

On the other side are critics like Raghu Rajan, former IMF chief economist, who argue that the Fed should start raising rates now. Low interest rates simply keep the economy on artificial life support. They have the undesirable side effect of fostering the same imbalances that set the stage for the crisis. They encourage releveraging by the financial services industry and relieve the banks of having to worry about liquidity, just as before 2008. They encourage excessive spending and debt accumulation by U.S. households that should instead be deleveraging.

In particular, they encourage spending on housing and automobiles, two interest-rate-sensitive sectors on which the U.S. economy has become overly dependent. They thus interfere with the process of balancing the U.S. economy on a more sustainable footing. They only set up the country for another painful fall.

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The debate over federal fiscal policy similarly proceeds in parallel. On one side are those, like the business economist Mark Zandi, who are preoccupied by the weakness of the economy and stress the need for continued support for aggregate demand. They observe that the impact of the stimulus peaked in the first quarter and worry about the implications of allowing the Bush tax cuts to expire at the end of 2010.

On the other side are many voices arguing that the United States needs to save more in order to avoid the mess it got into in the last decade. While households are now saving more, the increase in national savings for which they account has been entirely offset by less government savings. As a result, the U.S. is becoming even more heavily indebted to the rest of the world. The trade deficit, having shrunk temporarily during the crisis, is rising again toward pre-crisis levels. If foreigners at some point become unwilling to bankroll that deficit, the consequences could be dire.

Meanwhile, efforts to rebalance the economy toward exports in order to double U.S. exports in five years, the goal set by President Obama, have been frustrated. Only a concerted effort to cut the budget deficit, it is argued, can finally get the U.S. started down this road.

The two sides in the debate over fiscal policy are thus making exactly the same points as their counterparts in the monetary debate. And because both sets of economists are making the same arguments — without realizing it — you can lay them end to end, and they still will never reach a conclusion.

Once one realizes that exactly the same arguments are being made in the monetary and fiscal contexts, some powerful implications follow. First, budgetary policy is better suited than monetary policy to encourage rebalancing the U.S. economy away from housing and toward workforce skill formation. If the U.S. needs more skilled workers in order to export more, then the budget is the appropriate instrument for financing the expansion of vocational training. If the U.S. should be investing less in housing in the medium term, then eliminating the federal tax deduction for mortgage interest — that is, using the revenue side of the budget — is again the most effective way to achieve this.

Interest rates, in contrast, are too blunt an instrument for changing the mix of investment away from housing and toward workforce skill formation. The Fed can contribute modestly to this adjustment by replacing its maturing residential mortgage-backed securities with treasury bills — not more mortgages — as its current holdings mature. But the main thing that monetary policy can and should do, so long as the expansion remains weak, is to support aggregate demand and prevent deflationary expectations from setting in.

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Policy makers may still have reason to worry that near-zero interest rates will encourage excessive leverage by banks and borrowers. This problem should be appropriately addressed by the Fed in its capacity as regulator. Fiscal policy, on the other hand, can be deployed in dozens of ways to encourage rebalancing. Most obviously, shifting from an income to a consumption tax would encourage saving over spending. Tax incentives for investing in clean energy and high-speed rail would help to limit motor vehicle and energy imports.

On the export side, more investment in roads, ports, and bridges — rather than homes — would help to make the country’s exports more competitive. Federal financing for vocational training to provide more machinists could be extended to college degrees for service-sector workers, analyses by the International Trade Commission having shown that the service sector provides important support for exports. The federal government could also more adequately fund the regulatory agencies that monitor the country’s food supply so that foreign consumers put off by past reports of tainted American meat will overcome their fears. And it can be more generous in providing credit guarantees for exporters.

President Obama and his defense secretary, Robert Gates, foresee the opportunity for far-reaching cuts in the U.S. defense budget. Once a durable recovery is underway, the money saved should be used to reduce the federal deficit. But until that time, it is best used for ramping up public programs that contribute to rebalancing.

Oh, and since Federal Reserve policy will remain loose for the foreseeable future, we will also be able to rely on a weak dollar to boost exports and help to rebalance the economy.
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How services contribute to the current account deficit

The current account deficit in Brazil’s balance of payments in Brazil up to July 2010 was US$28 billion. This value is already higher than the total for 2009, when the deficit was US$24 billion. According to the Central Bank’s Focus report, market participants estimate a deficit up to US$50 billion in 2010 and US$58 billion in 2011.

The trade balance is the main determinant of the current account balance. The emergence of the deficit after 2008 is explained by a fall in trade balance surpluses (see chart). In Brazil, the debate on how to reduce the deficit on the current

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account centers on the trade balance. However, the deficit in services has also contributed significantly to the deterioration of the current account.

Information technologies have transformed the trade in services. Tasks that were developed exclusively in domestic markets are now being traded between countries; examples are telemarketing and medical diagnosis on line. Companies have outsourced tasks abroad, such as accounting services. In this context the potential for export of services is not limited to tourism. Easier communication has up opportunities for transacting a variety of knowledge-intensive services such as call centers and data entry. So keeping an eye on trade in services should be an integral part of foreign trade policy of Brazil.

The deficit in services has grown dramatically, from US$2.8 billion in the first quarter of 2009 to US$7.6 billion in the second quarter of 2010 (see chart). There were no changes in the composition of the tariffs on services in recent years, as occurred in trade flows of goods, where the share of manufactures fell.

Professional and technical business services account for 41% of service exports; of these engineering services comprise 48% of the total. Brazil exports services of high quality. International travel, which includes tourism, is the second source of income (21%), followed by transport (17%). In the international market, in 2007 Brazil was the 13th largest exporter of insurance and the 12th of financial services, according to the latest data available from the World Trade Organization. In insurance and financial services, in particular, the Brazilian presence is associated with mergers and acquisitions in the country’s financial sector.

Financial, communications, trade and brokerage,
To encourage service exports, it is necessary to invest in telecommunications infrastructure and a qualified workforce.

In Brazil, access to new information technologies and telecommunications, such as the Internet, is a public policy goal. New technologies are also key instruments in determining new comparative advantages. To encourage service exports, it is necessary to invest in telecommunications infrastructure and a qualified workforce — increasing the number of schooling years and the quality of education.