Regional Economic Climate
World economic climate improves, Latin America’s does not

Politics
Claiming the oil prize

IBRE Seminars
Brazil infrastructure
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Regional Economic Climate
Lia Valls
THE BRAZILIAN ECONOMY

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To deal with rising production costs in the last few years, Brasilia opted to slow the pace in developing the oil sector. As a result, output has virtually stagnated since 2010, raising concerns among international oil companies. João Augusto de Castro Neves analyzes Brazil’s current oil policy and explains why changes in the past few years may serve as a cautionary tale.

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10 Next year's elections already face headwinds
Uncertainty about the 2014 outlook for the whole world is very high, making it even more difficult to predict what will happen in the Brazilian economy. At a recent seminar, “Brazilian Economic Outlook for 2014,” Brazilian Institute of Economics (IBRE) researchers as well as other seminar participants presented a range of possible economic scenarios from deeply pessimistic to quite rosy. Fernando Dantas reports.
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Next year, again, economic performance will depend on such sensitive factors as the exchange rate and imports, particularly of oil. The exchange rate in particular is more volatile because of the surge in the U.S. dollar, which is not encouraging for Brazilian exporters but will also affect imports. Brazil must also deal with the consolidation of the regional Pacific Alliance. Solange Monteiro reports.

EXTERNAL SECTOR: Uncertain future
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IBRE SEMINARS
22 What Brazil and China can learn from each other
Chinese and Brazilian experts gathered at two seminars late November in Rio de Janeiro to celebrate publication of The Middle-Income Trap: Visions of Brazil and China. If both countries are to sustain their growth, they must now consolidate the opening of their markets while also securing a balanced social safety net to reduce inequality. Solange Monteiro explains why the challenges for each country are different.
27 Uncertain road
Increased demand has outpaced the expansion of infrastructure in Brazil. Concessions for infrastructure projects have been awarded, but investors are still concerned about economic uncertainty, and about regulation for all modes of transportation. Solange Monteiro discusses the options.

REGIONAL ECONOMIC CLIMATE
33 World economic climate improves, Latin America’s does not
In all surveys since January 2013 the economic climate in Latin America has been worse than in the world as a whole. Lia Valls explores reasons for the region’s economic problems.
ECONOMY

Unemployment falls to 5.2%
Brazil’s official unemployment rate decreased to 5.2% in October despite a continuing slowdown in the economy. However, unlike previous years new job vacancies are growing only moderately. At 23 million employed workers in October there was no significant increase compared to October 2012. (November 21)

Brazil corporate delinquencies soaring
Delinquencies by Brazilian firms of all sizes, from defaults on bank loans to unpaid utility bills, rose in October from September by 13%, the fastest monthly pace in a year, credit research company Serasa Experian said. (November 27)

Trade balance posts a surplus
Brazil’s November trade surplus of US$1.7 billion was well above expectations, according to the Ministry of Development, Industry and Trade. For the year to date, the trade deficit was US$89 million, compared with a surplus of US$17.2 billion for the same period last year. (December 3)

GDP falls in third quarter
GDP fell by a seasonally adjusted 0.5% in the third quarter of 2013 compared with the previous quarter, IBGE reported. Investments, stagnation in manufacturing, and the end of record grain harvests led to Brazil’s worst quarterly performance in two years. IBGE also revised GDP growth in 2012 from 0.9% to 1%. (December 3)

Surprises in October industrial production
Industrial output rose 0.6% in October compared to September after increasing a revised 0.5% in September, IBGE reported. Output of intermediate and consumer goods rose by 0.3%, while capital goods production jumped 0.6%. Vehicle production dropped 3.1%. (December 4)

Inflation hits 0.54%
The official inflation rate as measured by the Broad Consumer Price Index (IPCA) increased 0.54% in November, 0.03 percentage points below the rate recorded in October, according to IBGE. The slowdown was driven by lower food price inflation. (December 6)

EDUCATION

Brazil still doing badly in education
Though slowly improving the quality of teaching, Brazilian education is still ranked near the bottom, according to the Program for International Student Assessment (PISA), which assesses 15- and 16-year-olds on math, reading, and science. In math, Brazil ranked 58th among 65 countries; in reading, Brazil is still 55th, as in 2009, and in science still 59th. The tests were taken in 2012, and 85% of students evaluated attend public schools. (December 3)
ECONOMIC POLICY

US$9 billion awarded in airport deals
Brazil has awarded US$9 billion worth of contracts for private management of two of its busiest airports in a hotly contested auction to overhaul crowded terminals ahead of the 2014 World Cup and the 2016 Olympics. Though private operators will be running the international airports in World Cup host cities Rio de Janeiro and Belo Horizonte next year, there will be little time for investment in upgrades before the tournament in June. Local contractors and foreign airport operators won the two concessions, paying a premium of more than 250% over minimum bids to cash in on a recent boom in Brazilian air travel. The Rousseff administration has struggled to restore its credibility with the private sector after investor complaints of its heavy-handed approach to concessions in the power industry and elsewhere. (November 22)

President ducks a change in its fuel price formula
President Dilma Rousseff is reluctant to allow state-controlled oil company Petrobras to adopt a fuel price policy that would automatically raise gasoline prices to match inflation, newspaper Folha de S. Paulo said, adding that the government is willing to sign off on an increase of about 5% for gasoline and 10% for diesel but not until 2014. Because the government has kept consumer prices below international market prices, Petrobras has lost more than US$10 billion at its refining division in the past few years. (November 26)

Subsidies and tax breaks to be scrapped, but no spending cuts
To keep the country’s fiscal policy sound, Finance Minister Guido Mantega said, the government will remove some subsidies and delay tax breaks, and the state development bank, BNDES, will cut credit lines to regional government next year.

Meanwhile, in an interview with Spanish newspaper El Pais, President Dilma Rousseff said reducing federal spending to keep public accounts sustainable is not necessary. “We do not have debt like Spain,” she said. “We have net public debt of 35% of GDP [gross public debt is 56%]. The discussion in Brazil is whether the primary surplus will be 1.8% of GDP, 1.9%, or 2%, not about whether we increase debt,” Rousseff said. She also celebrated the latest oil and airports concessions and predicted a successful auction for highway and gas field concessions. (November 26)

Budget surplus disappoints
October’s primary fiscal surplus (nominal fiscal balance less interest payments) of R$6.2 billion was below market expectations. In 12 months, the general government consolidated primary surplus fell to 1.44% of GDP, from 1.58% in September. The federal nominal deficit widened to 3.4% of GDP in October. For the last two months of the year, an improvement in tax revenues, mainly due to a tax amnesty program, bonuses from oil field auctions, and dividends from state-owned firms are expected to keep the primary fiscal surplus for 2013 at about 1.7% of GDP. (November 29)

Central bank raises interest rate and extends forex program
The bank decided to raise its benchmark interest rate by half a percentage point to 10% in order to curb prices, but signaled in its decision statement that it may slow the pace of rate hikes to focus more on economic growth. (November 28)

The central bank will extend into 2014 the program of offering a hedge to investors by selling currency swaps with some adjustments, bank governor Alexandre Tombini said on Thursday. The US$60 billion program of swaps and credit lines auctions was announced on August 22nd as a measure to prevent an excessive weakening of the currency and to mitigate excessive currency volatility. (December 5)
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What can Brazil hope for in 2014?

This year’s rapid erosion of Brazil’s public finances has alarmed financial markets. The possibility of a sovereign rating downgrade next year is already scaring off investors and threatening to undermine Brazil’s feeble recovery.

As leading candidate in the polls for the 2014 presidential election, President Dilma Rousseff is betting on holding the line until after the elections, hoping that no major external shock hits Brazil. Her administration is counting on the extraordinary cash revenues flowing from corporate tax settlements and from the oilfield auction bonus to beef up Brazil’s finances, which are already under close scrutiny from investors—and rating agencies.

True, the Rousseff administration seems to be slowly changing its policies. The central bank appears to be serious about fighting inflation—its monetary tightening has certainly turned aggressive, and the government has announced it will remove some subsidies, put a hold on tax breaks, and reduce the subsidized lending of public banks. The administration is also making friendlier overtures to business. The recent successful auctions of airport and road concessions to private businesses are excellent news for a government struggling to restore its credibility with the private sector.

Unfortunately, though recent policy changes have the merit of addressing some of the most urgent problems facing the country, the government’s piecemeal approach does not in any way reflect a grand strategy. A more profound adjustment of fiscal accounts is simply not in the cards. It is extremely unlikely that in an election year the government will curb public spending. In fact, in a recent interview with the Spanish newspaper El País, the president flatly dismissed that idea.

Failing any intent to do a fiscal adjustment, the best thing the government could do instead would be to avoid any of last year’s accounting gimmicks and fully disclose the country’s total public sector deficit and gross public debt. Critics say, correctly, that the government’s rather casual use of one-off income items has undermined its credibility, which was severely damaged by repeated adoption of accounting gimmicks to put a high gloss on its fiscal results. Unfortunately for the Rousseff administration, accounting gimmicks do not work anymore. People see through the manipulation, and the administration may as well get rid of them.

To make the budget deficit more transparent and therefore more credible, Brazil needs an independent budget office like the U.S. Congressional Budget Office. Of course, setting one up would prepare the way for a fiscal adjustment—but that will be unavoidable anyway.

Since major policy changes are undoubtedly on hold until after the 2014 presidential elections, whoever is elected then will certainly face very unfavorable conditions and the policy choices will be much more difficult for having been pushed into 2015. The next administration has to deliver better health, security, education, and public transportation services. It will also have to carry out fiscal consolidation and adjust the external balance of payments, which implies that it will have fewer resources available to improve public services. The victor will have our commiserations, rather than congratulations.
Claiming the oil prize

João Augusto de Castro Neves, Washington D.C.

WHEN HUGE OIL RESERVES were discovered beneath layers of salt, under the sea, Brazilian officials celebrated as if the country had won a lottery. The year was 2007 and the new discovery, which became known as “pre-salt,” more than doubled Brazil’s proven oil reserves. For a country often considered the Saudi Arabia of biofuels, the discovery led to a major identity change (crisis?) in Brazil’s energy policy.

What followed were a series of policy overtures that sought to alter regulation by enhancing the state’s presence in the oil sector. By 2010, Congress had approved a proposal that established a different exploration and production (E&P) regime for the pre-salt reserves. Instead of the traditional concessions regime that had been in place since the sector was opened to international oil companies (IOCs) in 1997, the government instituted production-sharing contracts in which state-controlled giant Petrobras would have a predominant role as sole operator, with a minimum 30% stake in every project.

As if favoring Petrobras would not be enough to alarm investors, early in President Lula’s first term (2003–06) the government also introduced ambitious requirements that IOCs buy local goods and services across the oil and gas supply chain. This targeted protectionism became a cornerstone of the government’s general industrial policy.

To deal with rising production costs in the last few years, Brasilia opted to slow the pace in developing the oil sector. Because Petrobras had a full plate—the company also faced restrictions on raising domestic fuel prices and otherwise improving its financial situation—the government refrained from calling new oil auctions. The five-year hiatus (2008–13) further delayed oil production, and output has virtually stagnated since 2010. Many IOCs began to reassess their projects in Brazil due to increasing production costs and lack of scale.

There were two main reasons for the administration’s policy choices: (1) When the government approved its new E&P framework, Brazil was enjoying a robust economic recovery (7.5% growth in 2010) following the 2008–09 global financial crisis and Brasilia was not desperate to attract more foreign capital or investment.
When Brazilian legislators approved changes to the E&P framework that same year, the pre-salt area constituted one of the more promising oil frontiers globally. These two factors gave the government the confidence to pursue its oil policy options.

Now the winds have definitely shifted. So where is Brazil’s oil policy headed? After three years of very low GDP growth, the Rousseff government seems to be placing a higher premium on measures to ensure that a pipeline of investments will drive a more robust economic recovery. While Petrobras as one of the chief public investments is surely seen as part of the solution, the government now also seems willing to attract private and foreign investments in oil. In 2013 alone, it held three oil bid rounds, including the first pre-salt auction in October.

But since 2010 other challenges have been emerging. New oil discoveries around the world and the technological revolution that has occurred in shale gas and tight oil in the United States may not only contain or even lower oil prices but may also draw more investment from IOCs. Collectively, the competitive dynamics in global energy markets may lead to some countries pushing market-friendly energy reform to offer more favorable terms to investors. Look at what Mexico is trying to do.

While much could change in the next few years, the government should be ready to respond promptly if the energy sector challenges become more intense. After all, Brazil is betting that future oil production will not only drive economic growth and industrial development but also bring about social justice (100% of royalties from future pre-salt production will fund healthcare and education).

Brazil is still well-positioned to become a major global energy player in the next few decades. Nevertheless, the changes seen in the past few years serve as a cautionary tale that if the pre-salt oil reserves were a winning lottery ticket, the ticket may have an expiration date.

New oil discoveries around the world and the technological revolution that has occurred in shale gas and tight oil in the United States may not only contain or even lower oil prices but may also draw more investment.
Next year’s elections already face headwinds

**Fernando Dantas**

As Brazil prepares for election year 2014, economic uncertainty is pervasive. It is likely that 2014 will not be as spectacular as 2010, but forecasts of what will actually happen vary considerably. On the negative end, Brazil would encounter a perfect storm that might combine one or more downgrades of its sovereign rating with a steep devaluation of the exchange rate in the wake of rising U.S. interest rates. The most optimistic scenario anticipates a gradual recovery in economic growth, and inflation still below the government inflation target ceiling of 6.5% a year.

In the November seminar “Brazilian Economic Outlook for 2014,” sponsored by the Getulio Vargas Foundation in Rio de Janeiro, contrasting views on the
forthcoming year were presented by Brazilian Institute of Economics (IBRE) researchers as well as other seminar participants.

Silvia Matos, coordinator of the IBRE Economic Outlook, set out IBRE’s baseline scenario, starting with GDP growth of 2.4% for 2013 and 1.8% in 2014. Matos pointed out that uncertainty about the 2014 outlook for the whole world is very high, making it even more difficult to predict what will happen in the Brazilian economy. Nevertheless, the baseline assumes a more favorable international scenario, with the euro area exiting from recession, continuing U.S. recovery, and stabilization of growth in China.

**The baseline**
The baseline scenario assumes that U.S. growth will accelerate from 1.8% in 2013 to 2.4% in 2014; as Europe comes out of recession, it will grow 0.8% next year after falling 0.5% in 2013; and China’s growth stabilizes at 7.3% in 2014 after hitting 7.5% in 2013. Matos noted that there has been a general economic slowdown in Latin America since 2010, but countries that have inflation under control, such as Chile, Colombia, Mexico, and Peru, have more room for monetary expansion to stimulate economic activity.

With its feeble GDP growth and high inflation, Brazil will have more difficulty conducting monetary and fiscal policies. Analysts consider it unlikely that the monetary tightening cycle that began last March will raise the benchmark interest rate much above the 10% set last November. The expectation is that early in 2014 the central bank will stop at 10.25% or 10.50%.

The GDP fall of 0.5% in the third quarter compared with the previous quarter (seasonally adjusted) was another

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**Brazil: IBRE baseline scenario, 2010-2014**

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<td>5.7</td>
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<td>Exchange rate (average, Reais per U.S. dollar)</td>
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<td>Budget primary surplus (% of GDP)</td>
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<td>1.6</td>
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<td>External current account balance (% of GDP)</td>
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<td>5</td>
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<td>Export (US$ billions)</td>
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<td>International reserves (US$ billions)</td>
<td>289</td>
<td>352</td>
<td>378</td>
<td>373</td>
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</tbody>
</table>

Source: Brazilian Institute of Geography and Statistics. Central Bank of Brazil. IBRE staff projections.

1 Excludes interest payments on public debt, revenues from dividends and concessions, and some investments of the Growth Acceleration Program.
Uncertainty about the 2014 outlook for the whole world is very high, making it even more difficult to predict what will happen in the Brazilian economy.

indicator that growth for the first term of President Dilma Rousseff is likely to be a rather unsatisfactory 2%. Thus, the central bank is walking a tightrope between the possibility of halting the frail recovery of economic activity and the risk of inflation expectations entrenching at levels well above the target mid-point of 4.5%. IBRE is projecting that consumer price inflation will close at 5.8% this year and keep moving up in 2014, to 6.1%.

In the baseline scenario, Matos said, fiscal policy has a crucial—and very worrying—role. The fiscal primary surplus (nominal fiscal deficit excluding interest payments) to stabilize the public debt-to-GDP ratio should be about 2.5% of GDP, but IBRE projections of the effective fiscal primary surplus in 2014 (excluding nonrecurring revenue) are only 0.8% of GDP for 2013 and 0.5% in 2014. Clearly, monetary policy should not expect any support from fiscal policy to contain inflationary pressures.

Market participants also perceive that the fall in the fiscal primary surplus is not related entirely to the business cycle but is more permanent. Matos pointed out that expansion of the tax cuts has reached 1.6% of GDP, which means a substantial loss of tax revenues. While reversing some tax exemptions could recover about 0.5% of GDP in revenue, a large part of social spending (including education and health) is adjusted in line with increases in the minimum wage, and mandatory spending is already a large share of total expenditure. Thus, she said, the nominal fiscal deficit could reach 3.5-4% of GDP in 2014.

The gathering storm

The likely fiscal underperformance creates uncertainty about how sustainable public debt is. Brazil’s gross public debt of about 60% of GDP is in the crosshairs of investors and international rating agencies; in 2013 Brazil saw its rating outlook worsen. Though Standard & Poor’s and Moody’s have not yet actually lowered the rating, their negative outlook may eventually cause a downgrade.

The perfect storm scenario would combine one or more rating agency downgrades of Brazilian debt with a significant increase in U.S. interest rates as the Federal Reserve tapers off its monthly purchases of US$85 billion in U.S. government bonds. The consequent strengthening of the dollar could trigger a sharp devaluation of the Brazilian real and unleash acute inflationary pressures that would force the Central Bank of Brazil to tighten monetary policy even more. That would certainly have negative consequences for economic activity and the employment.

Seminar participants also looked beyond 2014 to discuss 2015 policies to address Brazil’s economic imbalances.
— the consensus being that any serious policy adjustment in an election year was implausible.

Without policy adjustment
Armando Castelar, IBRE researcher, put forth the view that adjustment in such policies as controlled prices for fuel and bus fares might not take place even in 2015. He noted that the list of unpopular policies to contain inflation and reduce the external current account deficit is extensive: correction of fuel prices, elimination of tax exemptions, and tightening of monetary policy, which would be combined with rising unemployment and falling real incomes.

State-controlled banks have inflated their loan portfolios, Castelar charged, and a sudden slowdown of the economy would not only bring about loan defaults but also require the Treasury to recapitalize state-controlled banks. At the same time, high interest rates and slower economic activity would exacerbate the difficult fiscal situation, requiring a level of austerity that is politically unpalatable.

As a result, Castelar believes, a serious adjustment of the Brazilian economy is unlikely to occur by voluntary government action; it would only come if the international situation worsened. In that case, the administration might be forced to change policies in order to reduce the current account deficit, which has reached 3.7% of GDP.

In 2014, Castelar predicted, the administration will not abandon the ideological convictions embodied in its “new economic policy”—a combination of

There has been a general economic slowdown in Latin America since 2010, but countries that have inflation under control, such as Chile, Colombia, Mexico, and Peru, have more room for monetary expansion to stimulate economic activity.

falling interest rates, a devalued exchange rate, and expansionary fiscal policy. However, postponement of the tightening of U.S monetary policy that was expected in September bought the time necessary for the Brazilian government to muddle through until the presidential election, in the hope that the fragile economy will not decisively affect the labor market.

The labor market has stayed strong even as the economy has been slowing since 2011. Unemployment remains low. This, of course, has contributed to the popularity of the government. If the poor performance of the economy had affected the labor market, pressure on economic policy would have been more intense, in Castelar’s opinion. But now growth in the employed population and in real incomes has slowed, and there is already a relative cooling of the labor market.

Optimism
Nelson Barbosa, former executive secretary of the Ministry of Finance in the Rousseff administration, outlined what would be the optimistic scenario
The GDP decline of 0.5% in the third quarter compared with the previous quarter, seasonally adjusted, was another indicator that growth for the first term of President Dilma Rousseff is likely to be a rather unsatisfactory 2% for 2014—without claiming that the optimistic scenario was the most likely, but noting that it should not be ignored. Barbosa argued that policy correction is already underway. For example, he said, the monetary tightening cycle started in March this year could allow interest rates to fall early in the next presidential term in 2015—assuming no new adverse demand shocks and that the government can manage to adjust controlled fuel and other prices gradually.

Barbosa also pointed to the recent government decision to reduce Brazilian Development Bank (BNDES) loan disbursements and thus transfers from the Treasury to the BNDES, which are to decline from R$190 billion in 2013 to R$150 billion in 2014. This measure would address concerns about off-budget spending and increase the fiscal primary surplus to 1.5–2.5% of GDP, depending on how the economy performs. He suggested that these policy measures would make fiscal policy more predictable and could build market confidence in the sustainability of public debt.

Assuming a more favorable international outlook and the absence of new negative shocks, the optimistic scenario would be 2–3% GDP growth in 2014, which would put GDP back on track toward an annual growth rate of 3.5–4.5%, which Barbosa considers to be the potential long-term growth rate of the Brazilian economy.
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Can the service sector grow?

Thais Thimoteo

WITH THE NEW YEAR APPROACHING, the outlook for growth in services, industry, and agriculture in 2014 is far from encouraging. Continuing monetary tightening, rising defaults, likely lower household consumption (partly because workers’ incomes are falling and the labor market is cooling), and high inflation are among the barriers to more robust economic growth in 2014.

There is consensus among analysts that in 2014 the performance of various economic sectors will be broadly the same as in 2013—and that portends weak growth. The exception is agriculture: although it is estimated to have grown 8% in 2013 it is projected to increase only 4.5% in 2014, according to the Brazilian Institute of Economics of Getulio Vargas Foundation (IBRE). Silvia Matos and Vinicius Botelho, IBRE researchers, expect that 2013 growth for industry will be 1.4% and for services 2%; the projection for 2014 is 1.2% for industry and 1.7% for services. IBRE expects 2013 GDP growth to come out at 2.4% and next year’s at 1.8%.

Matos explained that, “The Brazilian economy has many imbalances. Policy adjustments are necessary, for example, in the public budget and in controlled service prices, especially electricity rates. That will certainly affect growth [in the short term]. In an election year, the government will be reluctant to make any kind of adjustment.” She also is taking into account the risks of sporadic shocks to food supply and uncertainties about U.S. monetary policy, which could affect the Brazilian exchange rate. Rafael Bacciotti, economist, Tendências Consultoria, added that “Basically, we will live with low growth this and next year. There are numerous uncertainties regarding government economic policy that has generated inflation and other not very good results so far.” He projects 2013 GDP growth at 2.2%, followed by growth of just 2.1% in 2014.

Brazil: GDP projections compared (% change)

<table>
<thead>
<tr>
<th>GDP</th>
<th>Agriculture and Livestock</th>
<th>Industry</th>
<th>Services</th>
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<td>2013</td>
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<td>IBRE</td>
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<td>Itaú-Unibanco</td>
<td>2.2</td>
<td>1.9</td>
<td>7.3</td>
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</table>

Sources: Brazilian Institute of Economics (IBRE), Tendências Consultoria, and Itaú-Unibanco.
In addition, 2014 cannot count on the same excellent performance of agriculture as was seen in 2013, when it was pushed up by bumper crops and excellent livestock performance. There are also further signs of slowdown in the economy arising from the low level of business confidence in both industry and services as measured by IBRE surveys, which suggests there will be less investment in these sectors. Aloisio Campelo, IBRE deputy superintendent of business cycles, believes that even though the exchange rate devaluation improved its competitiveness, the outlook for industry will not begin to improve until the second half of 2014; by then, it is likely to have worked down its inventories. He explained that “The exchange rate, the extension of tax reductions on the purchase of automobiles, and increased sales of machines and equipment for agriculture gave breath to the industry in the first quarter of 2013, but in the second half there was an accumulation of unwanted inventories. Supply is now greater than demand.” He does not think that the factors that stimulated industry this year will be present in 2014: “Because household consumption is weakening, the confidence of the durable goods industry is in decline and the government cannot again resort to reducing taxes because the public fiscal situation is so difficult. How capital goods perform depends a great deal on business confidence—something I do not believe will improve any time soon.”

Specialists believe that what could drive industry production in 2014 is not the behavior of manufacturing but the recovery of mining, which crashed in 2013 as oil production declined because of the deadlock in granting concessions and delays in oil block auctions. “We estimate that mining dropped 3% this year. In 2014, we expect oil production to normalize, since concessions for exploration have started to be awarded. Thus, we can expect growth in this sector to be 5% in 2014,” said Aurélio Bicalho, economist, Itaú-Unibanco, which projects growth for industry to be 1.7% in 2014, up from 1.4% in 2013. He is also predicting GDP growth of 2.2% this year and 1.9% in 2014.

The services sector accounts for two-thirds of total GDP. However, it is difficult to imagine that it will grow stronger next year, Matos said. There is no evidence of increased efficiency in the sector, which is labor-intensive (with mostly unskilled labor) and needs investments in technology. “There is scope for innovation in the service sector, but it is not as simple as in industry, which can produce more by importing machines. To improve productivity in the service sector we would need to change our economic structure, and that cannot be done overnight,” she emphasized. Botelho added, “We can no longer grow by means of more domestic demand, which is the recent history of Brazil’s growth. We urgently need to improve productivity in the service sector. We have to carry out reforms that nobody wants to do.”
The QUESTION of what will happen in the Brazilian external sector in 2014 is surrounded by all the uncertainties troubling the international scenario. IBRE economists believe next year will come at a particularly delicate juncture, depending on the performance of such sensitive factors as the exchange rate and imports, particularly of oil—one of the main factors that affected the trade balance in 2013.

The 2013 decline in oil production was expected because of a scheduled maintenance shutdown of oil rigs. Exports of oil and oil products fell by 29% between January and November 2013 compared to the same period in 2012, which explains part of the 2013 increase in imports and the deterioration of the trade balance. The trade deficit of oil and derivatives totaled R$19.5 billion through November, compared with just R$5.6 billion a year earlier.

Even with the possibility that productivity will improve with upgraded oil rigs and new ones coming into operation, Mauricio Canêdo, IBRE researcher, has seen no reason to believe that the current situation will change much. “Oil sector investments are long-term; and there is no significant projected increase in either operating or refining capacity,” he said. The lower-than-expected increase in domestic gasoline prices announced in late November plus the lack of a clear policy for raising the prices of domestic oil products to meet international prices continues to stimulate domestic consumption of oil products.

“As long as domestic prices of gasoline and diesel are below the international market, they will continue to boost consumption and the pressures to import gasoline and diesel,” Canêdo

External sector
(U.S. billions)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013 est.</th>
<th>2014 proj.</th>
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<tbody>
<tr>
<td>Trade balance</td>
<td>19.5</td>
<td>1.0</td>
<td>5.4</td>
</tr>
<tr>
<td>Exports</td>
<td>243</td>
<td>239</td>
<td>246</td>
</tr>
<tr>
<td>Imports</td>
<td>223</td>
<td>238</td>
<td>240</td>
</tr>
<tr>
<td>Current account balance deficit</td>
<td>-54</td>
<td>-79</td>
<td>-74</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>-2.4</td>
<td>-3.6</td>
<td>-3.4</td>
</tr>
</tbody>
</table>

Source: Brazilian Institute of Economics.
pointed out. “Not to mention the added difficulty for the cash flow of state-controlled oil company Petrobras, which has an ambitious investment program ahead.”

The oil trade deficit has helped cause the external current account deficit to deteriorate; for 2013 it was 3.5% of GDP. IBRE economists indicated that correction of the current account imbalance can add pressure for even deeper exchange rate devaluation, even as the exchange rate is more volatile because of the surge in the U.S. dollar. “A stronger dollar could result in further depreciation of the Brazilian real. Moreover, the presidential election in 2014 could affect market expectations about government policies and add even more volatility to the exchange rate,” explained Lia Valls, IBRE coordinator of External Sector Studies, recalling the sharp exchange rate devaluation in 2002 before former President Lula was elected.

Import strength in 2014 will also depend on the exchange rate. Devaluation of Brazil’s currency in 2013 was not enough to cool external purchases. From January through November accumulated imports were US$221 billion, compared with US$205 billion in 2012. In the period, imports of capital goods increased by 5.6%, durable goods kept pace, and nondurable goods increased by 9.3%. Valls believes that the market reaction may be a sign of caution, anticipating purchases in the expectation of greater exchange rate devaluation. She added, “People nowadays are more exposed to international products, and substitution by national products takes time. I do not expect a huge increase in import substitution next year.”

Exchange rate uncertainty is not encouraging for Brazilian manufactures, which could be more competitive with further devaluation. “We still have a fragile export situation,” Valls said, pointing out that except for oil Brazil had a very small trade surplus in 2013, reflecting its dependence on commodity exports. In 2013, except for products with high unit value such as oil rigs and aircraft, Brazilian exports were sustained by Chinese demand for soybeans, iron ore, and sugar, which registered an increase of 12% through November compared to the same period of 2012, and by record exports of automobiles, which rose 47% over last year and mostly went to Argentina. “These were good results,” Valls said, “but if Brazil’s trade is limited to two countries, it is unlikely we will be able to increase exports.”

Valls noted that in 2014 the recovery of world demand will not be as vibrant as would be preferable, and in manufacturing Brazil may lose ground in South America now that the Pacific Alliance is consolidating. She said, “Markets like Chile, Colombia, and Peru are important for Brazilian manufacturers, and the Pacific Alliance block will almost immediately promote trade liberalization. We may lose market share in those countries because we export the same products as Mexico, which is also a member of the Pacific Alliance.”
Elections and the economy go hand in hand

Kalinka Iaquinto

Unlike recent election years, 2014 does not have a very favorable economic outlook. Nevertheless, political analysts claim that the worsening of the economic outlook for Brazil will not have much effect on politics until 2015, so it should not drastically affect next year’s presidential election. Nor, they believe, will the ballot be affected significantly by the World Cup outcome—which could bring both joys and sorrows—and echoes of the 2013 demonstrations that led thousands into the streets calling for better public services and ending the impunity of corrupt officials, and the scandals involving potential presidential candidates.

“We have a wave of scandals involving potential candidates, and that will compromise the debate on government programs,” said Marco Antonio Carvalho Teixeira, professor, FGV School of Business Administration of São Paulo (EAESP). “It is likely that once again we will have an election characterized by mutual accusations about who is more or less corrupt.

This is not positive from a political point of view.”

Fellow professor Carlos Pereira, Brazilian School of Public and Business Administration, FGV (Ebape), believes that there is a risk of recurring popular protests comparable to those seen in June this year: “The government responded in a very tentative way to demands of the protesters. The only concrete move the government made was to offer a greater number of physicians in primary health care; it did not solve the real issues of public health services. This and other public services, such as transportation, education, and security, are likely to be themes of the presidential elections.”

Analysts agreed that, unless something really extraordinary happens, given the current political climate and the possible candidates, the fight for the presidency will be between President Dilma Rousseff (Workers’ Party, PT) and one of the opposition candidates: Eduardo Campos or Marina Silva (both
Brazilian Socialist Party, PSB) or Aécio Neves (Brazilian Social Democratic Party, PSDB). In Pereira’s opinion, “Today the most likely candidate to face President Rousseff in the second round is Aécio Neves, because his party has nationwide coverage and local networks of interest. This is vital in running for president.”

Teixeira, however, believes the situation is not so clear. If Marina Silva were to replace Eduardo Campos as PSB candidate, he thinks, she would have more electoral density than the PSDB candidate: “She has a very strong presence in society. She would have huge capacity, perhaps even taking Aécio Neves out of the electoral race.”

According to a Data Folha survey, it appears that in all scenarios current President Rousseff or former president Lula would win the elections. If the dispute were between Rousseff, Neves, and Campos, Rousseff wins with 47% of the vote, followed by Neves (19%) and Campos (11%). When Silva replaces Campos, Rousseff gets 42% of the vote, followed by Silva (26%) and Neves (15%). In scenarios where Lula replaces Rousseff, the former president always wins more than 50% of the vote.

According to Ebape professor Daniela Campelo, the Brazilian economy is already being strongly affected by a less favorable international economy, and these are likely to increase popular dissatisfaction with the government, regardless of who is in power: “Changes in the international economy so far should not affect the elections—everything points to the victory of Rousseff. Nevertheless, [international factors] will affect her second term.”

In general, analysts agreed that the next government is not likely to shift economic policy to meet popular demands precisely because the international economy is less favorable. “Economic policy is something that governments do not control because it is associated with the behavior of the international economy. The government may invest more or it may invest less. And what differentiates the PT from PSDB, for example, is the quality of public spending,” Teixeira said.

The good winds from the international economy that favored the PT in the last presidential election are not blowing in the same direction. “The international economy today is very different from that in which former President Lula governed. In this sense he was lucky, as all those who were in power over the past ten years in South America. Similarly, governments in power right now have the bad luck of experiencing a much less favorable international economy,” Campelo pointed out.

“If Rousseff wins, [international factors] will affect her second term. People will begin to feel more directly the enduring impacts as the economy adjusts.”

Daniela Campelo
IN THE LAST DECADE, BRAZIL AND CHINA have drawn worldwide attention: China because it has become the second largest economy on the planet, and Brazil thanks to its exports of agricultural commodities and minerals and its booming domestic market. But both countries still require reforms if they are to sustain their growth. The challenge is to consolidate the opening of their markets while also securing a balanced social safety net to reduce inequality.

But the challenges for each country are different. While Brazil strives to increase domestic savings and overcome historical structural bottlenecks, China needs to slow investments and increase the share of domestic consumption in GDP. While China races against time to fix deficits in its social safety net as its population ages, Brazil needs to balance its extensive social safety net with curbing government spending and easing the tax burden. “It is as if Brazil were to take lessons on capitalism from China, and China had to learn something from Brazil about socialism, such as social inclusion and social benefits, but without overdoing it,” said Roberto Abdenur, CEO of Brazilian Institute for Ethics in Competition (ETCO) and former Brazilian ambassador to China.

This was the heart of the debate as Chinese and Brazilian experts gathered at two seminars late November in Rio de Janeiro. The event to celebrate publication of The Middle Income
IBRE SEMINAR

Trap: Visions of Brazil and China marked the first anniversary of the research partnership between the Brazilian Institute of Economics of Getulio Vargas Foundation (IBRE-FGV) and the Institute of Latin American Studies of the Academy of Social Sciences of China (ILAS-CASS).

THE STATE AND THE ECONOMY

Chinese experts stressed the directive issued at the Third Plenary Session of the 18th Central Committee of the Chinese Communist Party held a few days before the seminar, which favors greater private sector participation in the economy over the next decade. They believe it is important to reverse the recent expansion of state control. “Especially since the 2008 financial crisis, the government has intervened [in the economy] significantly, boosting monopolistic activities,” said Liu Xiaoxuan, ILAS-CASS researcher. Liu stressed the intensification of government control of land and capital markets and the rent-seeking activities that prioritize gains from monopolistic activity, deforming the productive structure. “Much of the government investment of 4 trillion yuan in 2008 ended up in the housing market, creating a bubble; the increased costs of the housing market caused costs to rise in other sectors, creating huge inflationary pressure that is difficult to manage,” she stressed.

During the 2008 financial crisis, Brazil experienced a similar dynamic, IBRE researcher Fernando Veloso pointed out: “The debate we now see in China about reducing monopolies and opening the economy began in Brazil in the 1990s and is still not finished.”

“we need a government that is more a service provider, which has regulatory functions rather than direct intervention. That means reducing the complexity of the rules, the tax system, and the consequent legal uncertainty.”

IBRE economist Lia Valls emphasized the need to restart reforms so that Brazil can break out of the middle-income trap—the loss of economic dynamism after a period of strong growth because of the country’s difficulty in transitioning beyond its current development policy. “For Brazil,” she said, “it is fundamental to improve productivity—which involves improving education quality and investing in innovation—to transition to a new stage of development that is no longer based on an import substitution policy.” She added that is also necessary to strive for a more open economy and to diversify markets and exports.

For China, Zheng Bingweng, director of
ILAS-CASS, argued that the foundations of the new stage of reforms should give priority to such critical points as reducing government intervention in how economic resources are allocated, streamlining bureaucracy, restructuring government, creating small and medium-size banks, letting the market determine interest rates, protecting patents, and moving more economic activity, which today is concentrated on the coasts, to the countryside.

Among the challenges the world’s second largest economy faces, Zhao Shengxuan, ILAS-CASS vice president, highlighted the need to promote innovation and improve income distribution. He explained, “We pursue the goal of doubling the income of the country by 2020. To achieve it within a harmonious and stable society, we have to eliminate the contradictions present in such key sectors as housing, employment, and education, and embrace development as a path. This is the strategy that will define the future of China.”

**SOCIAL ISSUES**

Establishing a social safety net that reduces inequality is a complex task for China because its population is aging and there are serious imbalances. In the last decade, while Brazil put up a good fight against inequality, in China inequality worsened significantly. “In Brazil, the reduction in inequality resulted mainly from a growing labor market, the policy of raising the minimum wage, and income transfers,” said Fernando de Holanda Barbosa Filho, IBRE researcher. Marcelo Neri, president of the Institute of Applied Economic Research (IPEA), pointed out that the income of the poorest Brazilians grew 120% in the last decade while the incomes of the richest went up only 26%. “Even so,” Barbosa added, “like China, Brazil is still a very unequal country.”

For the Chinese, lack of a more developed social safety net is risky because the advantage of a large untapped potential for urbanization—China is only 51% urbanized compared to Brazil’s 84%—also carries the risk of intensifying social imbalances. A major reason is that there are still in place remnants of the old planned economy, such as the *hukou* system of controlling geographical mobility. Guo Cunhai, ILAS-CASS researcher, said that, although it has become more flexible since the economy has begun to open up, *hukou* still represents an immense disadvantage for peasants migrating to cities, where they do not have access to health, education, and housing.

The Chinese hope that in the next decade,
urbanization will boost GDP, which so far has been driven mainly by investment and exports. “Among the factors that may contribute to this is the reform of the tax system, which began in Beijing and Shanghai; it is relieving the tax burden on the service sector and stimulating the creation of jobs there,” said ILAS-Cass researcher, Xie Wenze. However, his colleague Fang Lianquan believes that the country needs to address not just migration but also informality and access to public services. “This is still a great challenge that combines an aging population with a retirement system that also records low levels of benefits and coverage,” she said. “We have observed with interest the United States and Brazil. Our concern is the sustainability of social benefit costs. Will we be able to fund programs?” She pointed out that Brazil’s public spending on education, health, social security, and housing today represents 27% of GDP compared to China’s 14%.

The experts noted that Brazil needs to address the cost of the social safety net and social security so that it does not jeopardize the country’s growth. Fabio Giambiagi, economist at the National Bank for Economic and Social Development, pointed out that the fiscal impact of social security benefits is becoming increasingly serious partly because of the policy of indexing social benefits to a minimum wage that is regularly raised. Today, social security pensions linked to the minimum wage explain 26% of the reduction in inequality, but Valls emphasized that “social safety net excesses can influence the country’s business environment, since a high tax burden [to pay for benefits] undermines domestic savings, which, in turn, limits investment.” She noted that between 1990 and 2005 the Brazil tax burden rose from 25% to 35% of GDP.

Despite the success of Brazil’s social programs, Barbosa advocated for review of some policies. “Raising the minimum wage has a high fiscal cost and no longer addresses poverty,” he said. “Today, expanding the minimum wage by 10% would cost R$3 billion, but only R$100 million would reach the poorest,” he said. “In contrast, the Family Grant benefit is about 20% of the minimum wage, is better focused on the poor, and has a lower tax cost of only R$13 million for each R$1 increase in benefit.” Barbosa also questioned whether changing current social programs would be desirable, arguing that “we should focus more on improving teaching and specific regional policies. Because regional inequality in Brazil is large, reducing it could give better results at lower cost.”

“For Brazil it is fundamental to improve productivity—which involves improving education quality and investing in innovation—to transition to a new stage of development that is no longer based on an import substitution policy.”

Lia Valls
The Andrade Gutierrez is a global investment conglomerate that plays a successful role in more than 40 countries in the fields of engineering and construction, telecommunications, concessions, logistics, and energy. What makes it admirable worldwide is not only its breadth of achievement or its standards excellence; it is the AG Group’s capacity to reinvent itself. The AG Group has expanded its synergy by reinforcing its corporate culture and increasing the integration between its different areas and enterprises. It is the courage to innovate that makes the Andrade Gutierrez Group increasingly strong throughout the world and allows it to continually take advantage of new business opportunities.
Uncertain road

Concessions for infrastructure projects have been awarded, but investors are still concerned about economic and regulatory uncertainty.

SOLANGE MONTEIRO

THE AUCTIONS OF CONCESSIONS at the end of November for airports Galeão in Rio de Janeiro state and Confins in Minas Gerais state and for the BR-163 road in Mato Grosso state came to the government as a gift in these very difficult times. In addition to exceeding the projections, the auctions eased market frustration with the pace of public works and the concessions program announced a year ago. The expectation generated then was that 2013 would be a watershed in the infrastructure sector, especially transport. By October, however, investments in roads and railways were lower than those recorded in 2012 for the same period. At the seminar on “Infrastructure in Brazil: Perspectives and challenges in the area of construction, sanitation, transport, and logistics,” organized in November by the Brazilian Institute of Economics of Getulio Vargas Foundation, Elmar Varjão, managing director of Northeast OAS Industry, commented that “Everything is very new; government and private enterprise have discussed and sought agreement on several points. It takes time, but the debate has been productive. If going forward we can accelerate hiring, we will see results faster than expected.”
The majority of seminar participants agreed with Varjão that the advances are clear, even if the pace is less than ideal. Projections for 2014 are moderate. “Currently, we can see the deterioration of inflation and the fiscal stance, in addition to the foreign exchange risks,” said Luis Fernando Melo Mendes, economist, Brazilian Confederation of the Construction Industry (CBIC). “Moreover,” he added, “the presidential elections in 2014 increase the risk of political meddling in important votes in Congress, such as the labor law, which could raise production costs and increase doubts about the long-term outlook.”

Concern focused on the government’s delay in opening projects to the private sector. “The importance of the Growth Acceleration Plan (PAC) is unquestionable,” Mendes said. “It allowed for structuring the National Plan of Logistics and Transport, which established a more predictable long-term policy for government [engagement with] the private sector.” Previously, the lack of planning was costly for construction companies and other service providers. Uncertain and irregular demand for public works did not constitute the ideal environment for promoting investment in innovation and in productivity gains. “The Carioca Engineering Company, for example, started its activities to meet demand for public works in Rio de Janeiro state. However, we had to diversify customers, seeking more regular business,” Roberto Lauar, director of Carioca, said. Currently, the public sector accounts for 52% of the company’s contracts.

The problem, Mendes explained, was the insistence that the government carry out public works in the context of a tight fiscal budget. Mansueto Almeida, Institute of Applied Economic Research (IPEA), also pointed out that the government had little capacity to carry out public investment and finds it difficult to sustain investment when public spending increases.

**MULTIMODAL TRANSPORTATION**

Meanwhile, increased demand has outpaced the expansion of infrastructure. Varjão pointed out that “The number of passengers going through airports increased from 35 million a year in 2001–2003 to 84 million in 2009–2012; the number of vehicles per kilometer on highways managed by private companies increased

<table>
<thead>
<tr>
<th>CARGO TRANSPORTATION BY MODE</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USA (2011)</td>
</tr>
<tr>
<td>Roads</td>
<td>30</td>
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<tr>
<td>Railroads</td>
<td>51</td>
</tr>
<tr>
<td>Waterways</td>
<td>19</td>
</tr>
</tbody>
</table>

Source: National Bank for Economic and Social Development (BNDES).
from 52,000 to 90,000. Not to mention that the World Cup and the Olympics events created a demand for stadiums, urban mobility, telecommunications, hospitality, all at once.”

Although in some cases there will be a close race against time, the general assessment was that the road to addressing Brazil’s infrastructure deficit has been paved. To pay for the public works, however, Brazil will need a large infusion of capital. Joisa Dutra, coordinator, FGV Center for Studies in Regulation and Infrastructure, said, “So far we have not been able to achieve the best possible level [of financing]. Estimates point to a need for R$5 trillion in investment over the next 20 years, which would mean an average of R$250 billion a year.”

The Ministry of Transport expects demand for investment to add up to R$423 billion between 2012 and 2031. “The investments that we have are at about R$40 billion a year, about 0.9% of GDP, which already represents a clear expansion,” commented Dalmo Marchetti, manager of the Logistics Department, National Bank for Economic and Social Development (BNDES). Most infrastructure projects, he said, are structured on the project finance model, which requires an estimate of sufficient and predictable revenue. The largest BNDES portfolio is concentrated in railways and ports. The Inter-American Development Bank (IDB) has approved US$7 billion in financing for Brazil’s transport infrastructure for 2012–14. IDB transport specialist Karisa Ribeiro explained that the IDB focuses on highways and public transportation, commenting that “we have 16 projects in preparation, and more requests than we can meet.”

The Ministry of Transport expects that about half of its budgeted investment will be directed to railroads. Marchetti pointed out that “Countries of continental dimensions like Brazil have a relatively balanced multimodal transportation configuration, with a relatively large share of railroad transportation. The plan for the next 15 years is to expand the participation of railroads in total cargo transport from the current 25% to 35%, and also to explore the potential to increase use of waterways from 13% to 29% of cargo transport.” However, the market still has doubts about the current government concession model for railroads.

**INVESTMENT IN INFRASTRUCTURE—2013-2016**

<table>
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<tr>
<th></th>
<th>Total Value (R$ billions)</th>
<th>BNDES (%)</th>
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<td>Ports</td>
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<tr>
<td>Railroads</td>
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<tr>
<td>Total</td>
<td>157</td>
<td>40</td>
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</table>

Source: BNDES
Studies by Armando Castelar, IBRE economist, demonstrate that railroads have had positive results since privatization in the 1990s in terms of volumes transported, revenues, and investment, even as accidents were reduced. However, he suggested that the current concession model, which uses a state-owned enterprise to guarantee and manage demand for railroad services, may create governance risks: Even if there is no demand for railway services, the government will have to pay the railroad concessionaire, increasing the fiscal risk. CBIC’s Mendes added that regulation for all modes of transportation continues to be controversial, commenting that “Overall, we see a weakening of the regulatory agencies. Brazil has the Waterway Transportation Agency, but also the Secretary of Ports, the National Civil Aviation Agency, and the Department of Aviation. We have created a multitude of regulatory agencies that directly affect decisions.”

Manoel de Andrade e Silva Reis, coordinator, FGV Center of Excellence in Logistics and Supply Chain, emphasized the importance of multimodal transport and reducing the share of road transport in total cargo carried. “The 1993 port law made a difference, but it was not enough to develop international and domestic ship transport; I am optimistic that we can improve,” he said. “In the case of railways, the projected expansion of 10,000 km is large compared to the existing network of 28,000 km, but it is small compared to our needs. We have a large transportation capacity deficit, and railroads are important for Brazil.” Currently about 90% of transport operated by the JSL Intermodal Transport Company is focused on distances up to 300 km. Fábio Velloso, JSL Executive Director, said that improving logistics infrastructure means more than just expanding it. “We need more efficiency, and we advocate policy measures such as renewal of the truck fleet,” he said, noting the age of the average truck traveling on Brazilian roads is 17 years old. “We give incentives to use old trucks,” he said, “because they do not pay tax on ownership of a motor vehicle, but they emit more pollution, have a higher risk of accidents,

**MORE RESOURCES FOR URBAN PUBLIC TRANSPORT**

(R$ millions)

<table>
<thead>
<tr>
<th></th>
<th>Public Budget</th>
<th>Financing</th>
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<tr>
<td>2004-2007</td>
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<tr>
<td>2008-2010</td>
<td>631</td>
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<td>2011-2015</td>
<td>6,358</td>
<td>15,000</td>
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</table>

Source: Ministry of Cities.
and consume more fuel, reducing the productivity of transport operations.”

**URBAN MOBILITY**

It was agreed that efforts to reduce negative incentives should also be part of the public improvement of the supply of public transport in major cities but that will depend not only on investments but also on cultural changes and policies that in recent years have encouraged the population to use cars more. “It is impossible to base all urban mobility on individual transport,” according to Carlos Henrique Carvalho, IPEA researcher, who added, “In São Paulo city, for example, only a third of the car fleet can move simultaneously because there is no space to put all the cars on the street.”

“That does not mean abolishing cars; it means encouraging people to opt for public transportation in commuting,” added Luiza Gomide de Faria, director, Department of Urban Mobility, National Secretary of Transport and Urban Mobility. She pointed out that cars are responsible for 61% of the emission of pollutants by all vehicles and 73% of the energy consumption of roads and railroads.

In recent years, increasing Brazilians’ purchasing power and access to credit, combined with policies to control fuel prices and tax incentives for buying new cars, have caused the price of public transport to increase proportionately more than items related to individual transport. IPEA’s Carvalho pointed out that “As a result, in the last ten years, the sale of cars and motorcycles grew faster than GDP, while the number of passengers on buses dropped.”

To encourage more use of public transport in routine commuting, the experts recognized that it will also be necessary to significantly expand urban public transport. According to an IPEA study, Mexico City metro rail transports 1 million passengers per 10 km while in São Paulo city metro rail carries 2.7 million per 10 km. Carvalho estimated that metro rail and bus systems require annual investment of R$93 billion (0.3% of GDP).

Carvalho noted a positive debate on alternatives to public transport fares: “Today, those who finance the public transport system are the passengers, who are the poorest people. The ideal, however, is that the poor spend less, and the well-off contribute more to finance public transportation.” He argued for progressive taxes to fund public transportation—a mix of taxes on acquisition of vehicles and on gasoline. Other possibilities would be to increase property taxes, which 40% of the poorest do not pay, and to charge for use of urban public parking and roads.

“We need more efficiency, and we advocate policy measures such as renewal of the truck fleet. The average truck traveling on Brazilian roads is 17 years old.”

**Fábio Velloso**
COUNTRIES ARE BUILT

Health, education, jobs. The economic and social development of Brazil goes through the construction industry. Together we can forge a great country!

The CBIC, official representative of Brazil’s construction and real-estate industries at the domestic and international levels, engages through a continuous process of dialogue in developing and disseminating technological innovation and good practices of sustainability, in addition to measures aimed at boosting the sector’s efficiency and competitiveness.
World economic climate improves, Latin America’s does not.

Lia Valls
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THE ECONOMIC CLIMATE in Latin America in October remained stable compared with July as a worsening in the Present Situation Indicator (PSI) was offset by improvement in the Expectations Indicator (EI). But despite improved expectations, both indicators were below the historical average of the last 10 years, remaining in the unfavorable zone.

The Ifo-FGV indicator draws attention, however, to the divergence in economic climate between Latin America and the rest of the world. After the 2008 crisis, the economic climate in Latin America tended to be better than prospects for the world as a whole. China’s demand for commodities exported by Latin American countries and the low degree of integration of Latin America’s financial system with global markets were among the favorable factors that explain this result. However, since January 2013 there has been a reversal of fortunes: in all surveys the economic climate in Latin America has been worse than in the world as a whole. The effect of the downturn in commodity prices may be one reason.

The October survey, however, brings out additional reasons for Latin America’s deteriorating economic climate. Except for Chile and Uruguay, lack of confidence in government policies is one of the main problems mentioned—not a good sign, since investments depend on confidence in government policies. In addition, the low probability of a new boom in commodity prices highlights issues related to the lack of competitiveness and the shortage of skills in the Latin American workforce.

The Economic Climate Indicator is a quarterly survey conducted by the German Ifo Institute for Economic Research—the Ifo World Economic Survey (WES)—and the Brazilian Institute of Economics of the Getulio Vargas Foundation. The ECI is an average of the assessment of the current situation and expectations for the next six months based on the answers of country experts to questions on key macroeconomic data (consumption, investment, inflation, trade balance, interest and exchange rates). The indicators are weighted by the share of trade of each country in the region.

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