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Brazil needs a new governance compact to compel local, state, and federal governments to ensure that public services are excellent, Augusto Nardes, president of the Court of Audit (TCU), tells Kalinka Iaquinto. “Political parties must bear in mind,” he says, “that it is more important to negotiate projects for the country than projects for their own parties.” He also discusses Brazil’s competitiveness, corruption, and complaints that TCU hinders public works.

IBRE ECONOMIC OUTLOOK

27 Brazilian economy on hold
April brought little new in terms of short-term performance and prospects for the Brazilian economy. The outlook is at best lukewarm, with little change from the last month in terms of industrial production, investment, and inflation.
Hydroelectric production down by 30%
According to the National System Operator, 20% to 30% of thermoelectric power capacity is not available either for lack of fuel or technical issues, which means a heavier draw on reservoirs. (April 24)

Vehicle sales drop; 2,200 workers laid off
Vehicle sales fell 7.6% in February, said the Brazilian Institute of Geography and Statistics (IBGE), partly because a reduction in the industrial product tax that had stimulated, and satisfied, demand was ended. (April 15) The drop caused suspension of employment contracts and shutdowns of some of the operations of Volkswagen and Fiat, two of the largest car manufacturers as production was adjusted to demand. Vehicle sales for the 12 months through February were 5.3% lower than for the same period in 2013. Exports to Argentina, the main customer for Brazilian cars, fell more than 30%. (April 24)

Economic activity brakes suddenly in February
Brazil's economic activity slowed sharply in February, illustrating the weak start to the year. The central bank’s seasonally adjusted economic activity index dropped to 0.24%, after 2.35% growth in January, revised up from a previously reported 1.26%. (April 16)

Jobless rate drops, job creation slows
Brazil’s jobless rate unexpectedly plunged in March as fewer people sought jobs. From 5.1% in February the jobless rate declined to 5.0%, statistics agency IBGE said. Much of the decline was attributable to fewer job seekers as the labor force participation rate declined to its lowest level since March 2002. The formal sector created a lower-than-expected 13,117 jobs, 88% fewer than in the same period a year earlier. Inflation-adjusted wages rose 3.0% from March 2013 to an average of R$2,026 (US$904) a month—down 0.3% from February. (April 17)

Trade surplus narrows current account deficit
Though Brazil’s current account deficit narrowed in March after the trade balance improved, it was still the second largest on record for that month, according to the central bank. Latin America’s largest economy posted a current account deficit of US$6.2 billion, down from US$7.4 billion in February. A trade surplus of US$112 million in March, after two straight months of deficits, eased some of the pressure on the current account, but the surplus was the smallest since 2001. Brazil’s trade balance has been hard-hit by rising fuel imports and a drop in the prices of iron ore and other key exports. A steep depreciation of Argentina’s peso has also curbed Brazil’s manufacturing exports to its neighbor. (April 25)

Consumer confidence lowest in almost 5 years
Brazil’s consumer confidence index dropped by 0.8% in April to the lowest level since May 2009 because of repressed economic activity and inflationary pressures, the Getulio Vargas Foundation said. Lagging consumer confidence, accelerating inflation, moderating credit flows, and not much happening in the labor market are likely to discourage private consumption in the months ahead. (April 25)

Bank lending slows in March
Bank lending growth decelerated in March as bank spreads and interest rates went up. Credit to corporations slowed from 7.1% year-on-year in February to 5.5% and household credit dropped to 9.1% year-on-year from 10%. State-owned banks continued to widen their market share, which expanded from 51.7% to 51.9% in March. The percentage of nonperforming loans held steady at 4.8%. (April 30)

Inflation slows down in April
Brazil’s benchmark consumer price index (IPCA) of April rose 0.67% compared to 0.92% in March, said the government statistics agency, IBGE. 12-month inflation was up 6.28% in April compared to 6.15% in March. Despite slowing down, most food prices continued to rise by 1.19% in April compared to 1.92% in March, and health service and housing prices had noticeable increases. Brazil’s inflation problems are not likely to disappear soon. The recent food price spike is not the underlying cause of inflation, which is rooted in strong consumer demand and service price inflation. Also, there is a pent up inflation because the government controls many prices, including fuel, electricity rates and bus tariffs.
**POLITICS**

**Campos vows lower taxes and more predictable fuel prices**

If he wins the October election, Eduardo Campos, a centrist former state governor running for president, plans to lower the tax burden and set a formula for automatic fuel prices rises at state-owned Petrobras. Campos, 48, said he would implement a transparent formula for fuel price rises to cover costs. In a wide-ranging interview, Campos advocated reforms championed by Brazil's business community, which has largely soured on left-leaning President Dilma Rousseff after more than three years of slow economic growth. Campos says his message of improving Brazil's business climate while protecting the social gains made during the economic boom will catch on, especially as voters pay closer attention after the World Cup ends in July. (April 17)

**President pledges to boost social programs and reduce taxes**

President Dilma Rousseff has pledged to improve Brazilians' buying power, fight inflation, and stabilize the economy. In a televised speech before the Labor Day holiday, Rousseff said electricity prices will remain controlled and promised to investigate alleged corruption at government-controlled oil giant Petrobras. She also announced, with no details, an income-tax adjustment that would reduce how much Brazilians pay, saying it is "an important indirect salary gain and more money in the worker's pocket." A planned adjustment of personal income tax brackets will cost the government coffers R$5.3 billion in 2015, according to the Ministry of Finance. (May 1)

**Second round predicted for the presidential election**

A poll by the Sensus Institute shows President Dilma Rousseff (Workers' Party, PT) with 35% of the first round vote, Senator Aécio Neves (Brazilian Social Democratic Party, PSDB) with 23.7% and former Pernambuco governor Eduardo Campos (Brazilian Socialist Party, PSB) 11%. The margin of error is 2.2%. Among voters 66.1% have a neutral or negative view of the Rousseff administration, 49.1% disapprove of the president's personal performance, and 50% believe that Brazil is not on track. (May 3)

**ECONOMIC POLICY**

**Investments of US$33 billion expected**

Over the next 20-35 years federal concessions granted to the private sector in 2013 are expected to attract investments of US$33 billion in transportation, energy, oil and gas, and five permits to manage airports, according to the Secretary for Economic Monitoring. (January 10)

**March fiscal surplus slides**

Brazil's central and regional governments had a 12-month fiscal surplus (excluding interest payments) of R$86.2 billion in March, 1.75% of GDP, down from 1.9% the previous year. The March fiscal balance was the first reported since a budget revision that promised to curb spending—which instead accelerated over February's. The intense use of one-off revenues boosted the primary surplus but dented the transparency of fiscal policy. (April 30)
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The importance of getting the price right

IF A MARKET ECONOMY IS to work efficiently, prices and interest rates have to accurately reflect supply and demand; otherwise distortions in the economy will multiply, undermining productivity, innovation, and growth.

This issue analyzes one of the prices set by government: the minimum wage. The policy of keeping it rising well above inflation and productivity is controversial, though not totally without merit: After more than a decade, the policy has reduced inequalities in labor income, improved the lives of 48 million people, and fueled consumption-led growth. Especially in recent years, however, the policy has also raised labor costs far above productivity, and public spending has also shot up because pensions and other welfare benefits are indexed to the minimum wage.

Despite their widely differing views on the policy, a consensus is emerging among experts on the need to slow adjustments to the minimum wage and peg it to productivity rather than GDP growth. One proposal is to adjust the minimum wage to the average wage, which would better reflect the increase in labor productivity.

Also suggested was setting minimum wages according to the average wages in each state to better reflect local labor productivity. In the Northeast, the unemployment rate is 9% of the workforce, compared to 3% or 4% in Rio de Janeiro state. One of the reasons for high unemployment and informal labor in the Northeast region compared to the Southwest is probably that the minimum wage has been outstripping productivity there. In large and diverse countries like the United States and Canada, the local authorities establish minimum wages. In Germany, the minimum wage is often set by sector through collective bargaining agreements.

The government also controls other prices; regulated fuel prices, for example, have implications for domestic consumption of fuel, the external trade balance, and the financial position of the state-owned oil company Petrobras. A transparent formula for fuel prices is also long overdue.

Finally, the government subsidizes interest rates on loans for productive investment. The most important is the lending rate of the National Development Bank (BNDES), which is far below market rates. To finance this subsidy, the Treasury borrows at market interest rates and lends what it borrows at lower rates to the BNDES. Armando Castelar, researcher at the Brazilian Institute of Economics, estimates the cost of this subsidy at 1% of GDP a year, which will go up if the BNDES lending rate is not adjusted. Castelar believes that the low BNDES lending rate encourages companies to borrow from BNDES to invest rather than investing out of their own resources, which instead they use to buy profitable government bonds. This may explain why subsidized credit has not been able to raise anemic productive investment in Brazil, which is near the bottom for emerging countries.

The next administration will have to move swiftly—the sooner the better—to correct the minimum wage, fuel prices, and interest rates, and this will put pressure on inflation. The next administration will have to move swiftly—the sooner the better—to correct the minimum wage, fuel prices, and interest rates, and this will put pressure on inflation. How controlled prices and interest rates are adjusted will need to be managed with care. Adjustment of controlled prices should be transparent, and fiscal and monetary policy will both have to be tightened accordingly.
Beyond Latin America’s trade divide

João Augusto de Castro Neves

MUCH HAS BEEN SAID and written about the growing contrast in trade policy between Latin America’s Pacific and Atlantic sides. Mercosur, the region’s largest trade bloc, is still beleaguered by trade disputes among its member states and outright violations of the bloc’s rules, which certainly prevent the flourishing of a more proactive trade policy agenda. The Pacific Alliance, an incipient but promising initiative, seeks to build up commercial ties between the region’s more open and market-friendly economies.

The distinction between the two sides is clear, but the line that currently divides Latin America will become blurred in coming years as the region contends with lower growth rates.

A more challenging macroeconomic environment will usher in a period of less protectionism and more trade liberalization throughout the region, though at different intensities in different countries.

For the more protectionist countries on the Atlantic side, inflationary pressures or the need to attract dollars into their economies will raise the cost of pursuing the active industrial policies often associated with protectionism, so although still lurking, trade protectionism will be pushed down the ladder of policy priorities. For the more open countries on the Pacific side, the challenge for leaders will be to rebalance trade relations with and better manage dependence on the two most important markets, the US and China.

While elections may influence and potentially alter each country’s trade policy preferences—especially where significant political shifts have happened recently (Paraguay 2013; Chile 2014) or are expected to happen (Argentina 2015)—a more challenging macroeconomic environment is likely to usher in a period of less protectionism and more trade liberalization throughout the region, though at different intensities in different countries.

The Pacific Alliance will likely grow in coming years. While domestic politics will continue to matter, the trade policies in most countries already in the bloc will mostly be driven by global factors and the need to diversify exports. Much of the Alliance’s potential to boost trade

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and attract new members will hinge on the success of US-led negotiations, such as the Trans-Pacific Partnership (TPP). The bloc’s more open economies will seek reassurance about the benefits TPP may bring, in terms of both trade diversification and foreign investment. A successful TPP would enhance the potential of the Pacific Alliance and make it more attractive for other countries to join, especially the smaller ones in Central America and, less likely, Uruguay and Paraguay on the Southern Cone.

In the countries on the Atlantic side, domestic variables will have a much larger role in determining trade policy outcomes than in their Pacific Alliance neighbors. Over the years, trade policy in Brazil and Argentina has been subordinated to competing economic goals, chiefly regarding industrial policy. Other variables, such as concern over inflation, have also frequently interfered with a coherent trade policy. Rising inflation in Brazil and macroeconomic imbalance in Argentina may not signal a full-blown reversal of protectionist measures or a wholesale shift toward a more liberal trade negotiation agenda in the near term, but these trends strongly suggest that protectionism is waning as a serious policy option.

A wholesale shift in Mercosur’s trade strategy in the medium term is still unlikely. However, a more challenging economic environment and the likely progress of mega-trade agreements like the TPP and the US Transatlantic Trade and Investment Partnership (TTIP) with the EU, have already prompted shifts in priorities for the bloc’s members. Nearly 10 years after a first failed attempt, a Mercosur-EU deal is now within reach. While there continues to be resistance, Brazil is willing to present an offer encompassing nearly 90% of the country’s total trade with the EU and rules on government procurement, services, and investments.

Ultimately, in the longer term these negotiations may help promote the idea of free trade within Mercosur countries. Besides creating a precedent for bending the bloc’s rules, by allowing each country to liberalize trade at different speeds, a Mercosur-EU deal would also help demystify some traditional concerns that prevent these countries from liberalizing their economies, thus strengthening the still fragile pro-free trade lobbies in most of them. In Brazil, for example, recent support from the industrial sector for a free trade agenda represents an important change for a historically protectionist group.

Mercosur, the region’s largest trade bloc, is still beleaguered by trade disputes among its member states and outright violations of the bloc’s rules, which certainly prevent the flourishing of a more proactive trade policy agenda.
MINIMUM WAGE

IS TIME RUNNING OUT FOR THE MINIMUM WAGE POLICY?

Economists analyze proposals for revising minimum wage policy in 2015 and ask, Should it be based on productivity?

Solange Monteiro

THE MINIMUM WAGE has been the focus of heated debates around the world. In developed countries where economies are growing slowly, the question is whether raising the minimum wage would stimulate domestic demand and boost growth. In the United States, for example, raising the federal minimum wage has become a priority for President Barack Obama, who believes doing so would have a beneficial impact on the welfare of at least 28 million Americans. In Germany, where wages are set by collective bargaining agreements, the Social Democrats want to set a minimum wage but Chancellor Angela Merkel is opposed because she fears that higher labor costs would reduce the competitiveness of German exports.

In Brazil, after more than a decade of a policy of raising the minimum wage that has reduced inequality of labor income and fueled consumption-led growth, the debate is now back. The minimum wage law that has been in effect since 2007 is due for revision in 2015, which coincidentally is the beginning of a new presidential term. The question is whether the current rule of adjusting the minimum wage based on inflation...
in the previous year plus GDP growth two years before will be retained.

A central question for specialists is whether raising the minimum wage is sustainable when the economy is not growing much. According to the Unions Department of Statistics and Socioeconomic Studies (Dieese), counting the 6.78% increase in 2014 the minimum wage adjusted for inflation has risen 72% since 2002. Especially in recent years, this has raised labor costs far above productivity; public spending has also shot up because pensions and other welfare benefits are indexed to the minimum wage. Thus in Brazil the minimum wage now constitutes the base income for about 48 million people, according to Dieese: 26.5 million workers and 21.5 million beneficiaries of social spending.

Economist Nelson Barbosa, researcher at the Brazilian Institute of Economics (IBRE), says the minimum wage policy was right at first but adjustments are now needed: “I believe the policy was appropriate because it raised the minimum wage in terms of average salary in a manageable way. Ten years ago, the minimum wage accounted for about 30% of the average wage, and today it is 40%.” He notes that the fiscal situation then was solid enough to support the rise in the minimum wage. “The minimum wage should continue to increase above inflation,” he says, “but more moderately, so as not to create an imbalance in the labor market and not to put excessive pressure on the public budget.”

Samuel Pessôa, another IBRE researcher, believes it may not be wise to assess the minimum wage policy purely on technical considerations. It was a political decision that took into account the tradeoff between growth and equity. But, he says, in recent years the rule for adjusting the minimum wage to some extent has undermined GDP growth. “It is clear that the policy of raising the minimum wage has a direct impact on the welfare of many families,” he says, “but at the same time it reduces domestic savings and consequently compromises the country’s growth.”

![Brazil's minimum wage, 1940-2014](image)

*Source: Institute of Applied Economic Research (IPEA).*
The minimum wage should continue to increase above inflation, but more moderately, so as not to create an imbalance in the labor market and not to put excessive pressure on the public budget.

DIFFERENT CURRENTS

Early in May, Barbosa and Pessôa organized a seminar on minimum wage policy at the Getulio Vargas Foundation in Rio de Janeiro. Experts with different views on the issue were invited; the hope is that the proceedings will contribute to the policy debate for the government elected in October and help to inform society on the issues.

Seminar participant Carlos Medeiros, researcher at the Institute of Economics of the Federal University of Rio de Janeiro (UFRJ), has argued that the policy of raising the minimum wage has had a beneficial effect in modernizing labor relations and boosting more productive activities: “We saw in the Brazilian economy the minimum wage rising and informal labor declining at the same time,” he says. “The reduction of young and elderly people participation in the labor market was related to the Family Grant [which requires that children attend school] and better pensions [which are indexed to the minimum wage]. These reduced participation in the informal labor market,” he says. “At the same time, conditions for integrating people into the formal labor market improved. Formalization enabled access to credit for consumer goods. This also increased regulated employment and reduced informal activity.”

Pessôa, however, questions whether by itself stimulating consumption by the poor guarantees the sustainability of economic growth. “The fastest-growing country is China, which saves 50% of GDP,” he says. According to the International Monetary Fund, Brazil saves only 14%, compared to 26% in Russia, 24% in Peru, and 20% in Mexico. “The data from Brazil seem less unfavorable when compared to rich countries (the United States saves 17% of GDP). However, Pessôa explains, developed economies need to save less because they do not need to invest as much in infrastructure.

For Laura Carvalho, lecturer, São Paulo School of Economics of Getulio Vargas Foundation (EESP), the question is how to identify the unit labor cost that has negative effects on productive investment and the external trade balance: “It is not straightforward. In any case, Brazil has not yet reached that point; we still have the potential to increase consumption.” She warns, “We should not attribute the current slowdown of the economy to exhaustion of consumer-led growth. I think it has more to do with the recession in the world economy and some other factors related to fiscal policy.”

José Márcio Camargo, professor at Catholic University of Rio de Janeiro, believes the policy
of raising the minimum wage is already showing signs of exhaustion and is even undermining the labor market. He notes that "In the Northeast, the unemployment rate is 9% of the workforce, compared to 3% or 4% in Rio de Janeiro. One of the reasons for high unemployment and informal labor in the region may be that the minimum wage is high compared to productivity in the region."

CONSENSUS ON PRODUCTIVITY
Despite widely differing views, a consensus is emerging among experts on the need to slow adjustments in the minimum wage and start pegging it to productivity rather than GDP growth. IBRE's Barbosa suggests that for the next four years the minimum wage should be adjusted in line with the average wage increase or GDP per capita. "This would moderate the rise in the minimum wage, reduce the pressure on public budgets, and keep the minimum wage stable from a distributive standpoint in terms of average salary." He also argues that the ideal would be to calculate the wage as an average, for example for the last three years, in order to give more predictability to public spending.

Barbosa believes it is possible to continue raising the minimum wage and indexing pensions and welfare benefits to it if rules for granting three benefits are tightened: salary bonuses, unemployment insurance, and pensions for disability or death. Today, even if the minimum wage, pensions, and welfare benefits were adjusted only according to inflation, the three benefits would increase as a share of GDP," he says.

Pessôa argues that with the end of the demographic dividend and the elderly population growing relative to the working population, financing of the social security pension system will worsen and the cost of social programs will increase. "My opinion is [pensions and welfare benefits] should not be pegged to the minimum wage. People who earn one minimum wage pension from Social Security had paid social security tax based on a much lower salary," he says. "To finance these pensions without bringing back inflation, we will need to increase taxes on the entire society, which will discourage productive activity, investment and savings," he says. "If the people choose to improve income distribution at the expense of economic growth, it is all right to increase taxes. What is not possible is to make this choice and at same time demand that the government improves public transportation in the cities."
Minimum wage at the crossroads

Thais Thimoteo

WHEN THE CURRENT policy of adjusting the minimum wage was launched in 2007, many believed the job market would become distorted, generating an increase in unemployment and informal jobs. Another concern was that labor costs would increase for employers. If that had been correct, the labor market would have fared much worse than it actually did, since between 2007 and 2014 the minimum wage increased 30% above inflation, according to the Unions Department of Statistics and Socioeconomic Studies (Dieese). Someone who earned R$380 in 2007 earns R$724 today.

However, the predictions turned out to be wrong. Since 2007, the labor market has remained buoyant and unemployment low. The February employment survey by the Brazilian Institute of Geography and Statistics (IBGE) recorded 5.1% unemployment. No one can explain why the labor market is so resilient.

Two views
According to the 2012 National Household Survey (PNAD), the increase in the minimum wage has benefited about 26.3 million people, about 30% of the workforce. Carlos Corseuil, deputy director of the Institute for Applied Economic Research (IPEA), believes that the minimum wage policy has helped to reduce inequality in the labor market and has favored low-earning groups, such as youth and low-skilled workers.

Corseuil identifies two views on unemployment and informal jobs that have emerged since 2007. The first is that minimum wage increases have boosted the economy, generating more consumption. The second is that employers may have reacted to the increase in the minimum wage by changing the composition of their workforce. On this view, since employers have to pay higher salaries, they opt to hire skilled workers who can contribute more to produce and improve a product or service. If that is correct, there is reason for concern, Corseuil notes: “It would mean fewer job vacancies for unskilled workers, making them more dependent on welfare policies.”

So far the labor market does not seem to have suffered any major shocks. However, the problems may intensify if the modest growth in the labor force is confirmed in coming years. Raising labor productivity is the major challenge. If Brazil is to reach the 4% growth a year it needs to double per capita income in 20 years, it is essential to raise labor productivity. Fernando de Holanda Barbosa Filho, researcher at the Brazilian Institute of Economics (IBRE), estimates that growth in labor productivity has fallen from 2.8% in 2006–10 to 1.8% in 2010–13. “If the labor market becomes tighter, the chance of employers firing less productive workers becomes much greater,” he says.

Tension point
Claudio Dedecca, professor of economics, University of Campinas (Unicamp) and one of the authors of the minimum wage policy, says that the initial idea was to both benefit low-paid workers and at the same time build up the labor market and productive activity. But, he says,
“Although the minimum wage increased on average 6% to 6.5% a year, there was no strategy to expand productive capacity, raise technological standards, and improve workforce training to increase productivity.” That he sees as the main point of tension for the minimum wage policy: “Either we confront this problem of productivity by modernizing the productive structure and retain the current minimum wage adjustment rule, or we change the minimum wage policy if we cannot raise productivity.”

Another problem is high worker turnover, which can increase government spending on unemployment insurance. Corseuil notes that “The number of workers in the formal labor market has increased in recent years, which has increased the number of people who benefit from unemployment insurance. Worker turnover is astonishingly high in Brazil, and the higher the minimum wage, the higher the benefit paid to those unemployed.”

**Changes to the policy?**

Another question is whether the current rule for adjusting the minimum wage is the best option for the labor market. Rules for adjusting the minimum wage are set out in Law No. 12,382, of February 25, 2011, which is valid until 2015. The annual increase in the minimum wage corresponds to real growth in gross domestic product (GDP) growth two years before plus inflation in the previous year as measured by the National Consumer Price Index (INPC).

Dieese Director Clemente Ganz is emphatic that the valuation of the minimum wage is one of Brazil’s major policies, perhaps the most important of the last decade in terms of income distribution. The minimum wage policy, he says, “is a strategic policy of economic growth. And this is why we believe that it should not only be retained, but also expanded.” He adds that in the short term, there is no need to worry about the policy-related costs in terms of unemployment insurance and salary bonuses because the forecast for GDP growth in the next two years is relatively low, between 1% and 3%.

Unicamp’s Dedecca says that in any case changes to the minimum wage policy in 2015 are unlikely because of politics: “Next year a new administration will take office, and any change in the current minimum wage policy would require the administration to assume the burden of proposing new legislation to Congress. Will the new administration consider changing the minimum wage policy to be so strategic as to risk suffering a defeat at the start of the mandate? I think not.”

Barbosa Filho is more dubious about the current minimum wage policy because in terms of fiscal costs it is not a good deal. He considers the model of increasing the minimum wage according to previous real GDP growth and inflation is bad because it may coincide with an economic crisis and lead to higher costs for companies when they are not well off financially. That would trigger layoffs or bankruptcies. “I don’t know if there has to be a fixed rule for the minimum wage, either by GDP per capita or otherwise. The government chose the current minimum wage adjustment rule,” he concludes. “What I can say is that at some point the policy will have a cost in terms of fewer jobs. It is not possible to say when, but it will.”

**Another question is whether the current rule for adjusting the minimum wage is the best option for the labor market.**
THE MINIMUM WAGE POLICY, along with economic growth and expansion of education, has been a major factor in improving incomes in Brazil in recent years. A study by the Institute of Applied Economic Research (IPEA) based on the 2012 National Household Survey (PNAD) found that per capita household income increased by 8.9% above inflation in 2012. The highest growth occurred among the poorest 10%, whose income increased by 14% compared to 10% for the richest group. The share of population below the official poverty line (R$70 per capita in July 2011) fell from 4.2% in 2011 to 3.6% in 2012, helping 6.5 million Brazilians.

“Brazil today is the international benchmark for reducing poverty and income inequality, and research proves the importance of raising the minimum wage to the recent downward trend in income inequality and poverty,” stresses Márcio Pochmann, professor, University of Campinas (Unicamp). However, João Saboia, professor, Federal University of Rio de Janeiro (UFRJ), points out that the country still has a long way to go, because income distribution is still high by international standards (0.5 on a scale of zero to 1, where 1 means maximum income inequality). “The minimum wage policy has reduced inequality, so we have to weigh this positive aspect of the policy when we consider changing it,” he says.

Some economists argue that raising the minimum wage is not the most effective way to reduce income inequality and poverty. The Family Grant, the flagship social program of the Lula and Rousseff administrations, is not pegged to the minimum wage as other welfare benefits are; similar policies meet the needs of the poor and weigh less on the government budget. Fernando de Holanda Barbosa Filho, researcher, Brazilian Institute of Economics (IBRE), emphasizes that the fiscal cost of raising the minimum wage is very high. An increase of 10% in the minimum wage costs approximately R$3.1 billion at 2012 prices, of which only R$100 million would reach the poorest since less than 15% of them earn the minimum wage.

The difference between welfare benefits pegged to the minimum wage and the Family Grant is enormous. According to the Ministry of Social Development in 2013, 4.1 million individuals received welfare benefits that cost the treasury R$33 billion, compared to 14 million
households that received the Family Grant at a cost of just R$25 billion. “For the worker, the most important thing in a world is the salary increase. But it is much more expensive to reduce inequality by increasing the minimum wage than by paying the Family Grant. When more is paid to a worker, the government has to spend more on retirees, unemployment insurance, and all the other welfare benefits that are pegged to the minimum wage,” Barbosa Filho notes.

Naércio Menezes, coordinator of the Center for Public Policy of the Institute of Education and Research, is also concerned about the fiscal impact of the minimum wage policy, especially on social security pensions, although he acknowledges the positive effect of the policy in reducing income inequality. But, he says, “The situation of social security is becoming increasingly complicated due to the rapid aging of the population.” Nevertheless, he believes, “We can continue raising the minimum wage, [though] maybe not in the same magnitude as in recent years.” Menezes argues that the retirement rules need to be changed to somewhat offset the cost of raising the minimum wage. Unicamp’s Pochmann adds, “It is essential to raise the minimum wage until it reaches the same value as when it was created in 1940.”

As far as reducing inequality is concerned, Saboia and Menezes do not see a clear relationship between the minimum wage and the Family Grant. The two policies have different goals. The Family Grant program is geared to mitigating poverty; the benefit is lower than the minimum wage but reaches the poorest directly. On the other hand, as a benchmark for the labor market and welfare benefits, the minimum wage primarily affects workers and retirees and plays an important role in reducing income inequality. Saboia concludes, “It does not make any sense to say that if you put R$1 in the hands of the poor, the effect is greater than increasing the minimum wage by R$1 because the money will be more widespread in the economy. They are two very different things.”

“For the worker, the most important thing in a world is the salary increase. But it is much more expensive to reduce inequality by increasing the minimum wage than by paying the Family Grant.”

Fernando de Holanda Barbosa Filho

“The situation of social security is becoming increasingly complicated due to the rapid aging of the population.”

Naércio Menezes

3.6% Was how much household income grew a year in 2002-2012 compared to 2.5% a year in the previous 10 years.

5.3% Was the annual increase in the minimum wage in 2002-2012 compared to a fall of 0.22% a year in 1992-2002.

US$96 Was the per capita income of the 40% poorest Brazilians in 2012, compared to US$2,063 per capita for the 5% richest.


Was the per capita income of the 40% poorest Brazilians in 2012, compared to US$2,063 per capita for the 5% richest.
ONE OF THE POINTS THAT generates the most controversy about retaining the current policy for readjusting the minimum wage is the pressure the policy may bring to bear on government accounts. The problem is that increases in the minimum wage above actual inflation are carried over to pensions and other welfare benefits. This generosity may be beyond the capacity of the public budget, which in coming years will have to bear a substantial increase in the number of elderly in proportion to the economically active population. “Social security is what I call our Greek side,” says Fabio Giambiagi, economist at the National Development Bank (BNDES). “We have a fiscal system that, even though faulty in recent years, has a good Fiscal Responsibility Law; spending on personnel is falling as a proportion of GDP; and there are other positive factors. But our social security system is in general very generous and has true aberrations, such as women retiring at 52.”

The 1988 Constitution established that pensions and other benefits should be adjusted to increases in the minimum wage. Today, there are 26.6 million retirees, who accounted for pension payments of R$235 billion in 2013; 65% of them receive a minimum wage. Other welfare benefits include salary bonuses for those who earn up to double the minimum wage, death benefits, and unemployment insurance; these payments totaled R$118 billion in 2013. “Considering that the number of retirees increases by 4% a year and assuming annual GDP growth of 2.5%, with the current rule, social security payments would rise by 8.5% a year,” Giambiagi says. “If we add the impact on other welfare benefits, the total increase in payments would be equivalent to 1.2% to 1.3% of GDP.” He explains that though the increase seems small, if it is not interrupted, it will leave a disastrous legacy for future generations.

Not all experts are as pessimistic as Giambiagi. Economist Denise Gentil of the Institute of Economics of The Federal University of Rio de Janeiro (UFRJ) argues that the minimum wage policy and the rules of the pension system are fine. “I’m not saying there are no problems with its continuation, but there is no need to adjust the fiscal policy,” she says. “Our problem is the external financing constraint and low industrial growth.” Her calculations show that in recent years, contrary to the idea of a negative impact on public finances, social security revenues exceeded benefits: “For the past eight years, average growth of social security revenues was 8.7% a year while growth of social security benefits was 6.3%.”

Gentil underscores that the current policy cannot be seen as virtuous in itself; it must be accompanied by a program to push up productivity: “What we need is a good industrial policy, without leaving this path, or we risk reversing achievements.” She defends the theory that higher public spending on social security and welfare benefits has a major impact on aggregate demand. “This money is intended for children, the elderly poor, sick people with a high propensity to consume and to fully spend the income they earn,” she says. “Such growth stimulates increased domestic production, which in turn
boosts hiring workers, which will generate more GDP, and more income and tax revenues.”

For Marcelo Abi-Ramia Caetano, economist, Institute of Applied Economic Research (IPEA), financing social security has become an issue not only because of the increasing number of retirees but mainly because social security benefits are increasing faster than the wages of those who pay the social security tax. He advocates a middle way for adjusting social security benefits: calculating initial pensions and benefits based on the minimum wage and then adjusting them according to inflation: “This would be an alternative that would not eliminate but would ease the fiscal cost because it adjusts only the initial benefit, not the flow of new concessions. This would ensure that the benefit does not lose much purchasing power, which could leave poor people vulnerable.” But Caetano insists that any change in the minimum wage policy will work only if there is comprehensive reform of social security. For instance, death benefits ensure an integral pension for the widow without caps, which is not international practice.

Manoel Carlos Pires, IPEA economist, believes the concern about decoupling social security benefits from the minimum wage is a distraction in view of the need for full debate on social security reform generally. This view is supported by Nelson Barbosa, researcher at the Brazilian Institute of Economics (IBRE), who argues that the value of pensions and benefits can continue to track the minimum wage adjustment in line with higher productivity—if rules are revising for granting three benefits: salary bonuses, unemployment insurance, and pensions for death and accident. “With these measures, it would be possible to keep the social security benefits-to-GDP ratio stable and continue increasing the minimum wage above inflation,” he says.

In contrast, Giambiagi believes it is essential to decouple pensions and welfare benefits from the minimum wage. “We can draw a parallel between the social security issue and the environment: trends throughout the world each month may be no different from the previous month, but in 50 years the climate changes can be dramatic. If we do not make adjustments, in 30 years we will leave a disastrous legacy for future generations,” he stresses.

“I’m not saying there are no problems with the continuation of this policy, but there is no need to adjust fiscal policy. Our problem is the external financing constraint and low industrial growth.”

Denise Gentil

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**Brazilian Social Security: Revenues and expenditure**

(Billions of reais)

- **Revenues**
- **Pensions**
- **Death benefits**
- **Wage bonus**
- **Unemployment insurance**

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenues</th>
<th>Pensions</th>
<th>Death benefits</th>
<th>Wage bonus</th>
<th>Unemployment insurance</th>
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<td>81</td>
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<td>10</td>
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<td>163</td>
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<td>307</td>
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Source: Brazilian Institute of Economics.
The minimum wage pressure

Solange Monteiro

SLOW PRODUCTIVITY GROWTH not only compromises competitiveness, it also fuels inflation as wage increases outpace productivity growth. In the past eight years, the minimum wage rose on average 5.4% a year above inflation and average salary 3.4% a year, but labor productivity grew just over 1% a year. “When productivity growth is high, wage increases do not increase costs; when it is low, however, wage increases are likely to reduce employment and profit margins or increase prices,” explains Silvia Matos, researcher, Brazilian Institute of Economics (IBRE). Meanwhile, as the Central Bank points out, wage inflation can spill over into other sectors of the economy and amplify inflation.

Impact

The service sector, which represents 35% of the consumer price index, is labor-intensive, less exposed to international competition, and therefore more easily able to pass on its costs to prices. “Since 2003, the prices of several items that have considerable weight in the services price index have been rising along with the minimum wage,” says Ricardo Summa of the Institute of Economics of the Federal University of Rio de Janeiro (UFRJ). Mario Mesquita, a partner in Brasil Plural Investment Bank, explains, “The cost of services is basically determined by labor and rent, and today service inflation is about 9% a year. The policy of setting the minimum wage contributes to inflation in services.” Matos estimates that the contribution of the minimum wage to services inflation was about 0.8% a year from 2008 to 2012.

One of the main difficulties in defining how much the minimum wage affects inflation is the presence of another factor pushing wages up: low unemployment. Mesquita thinks that “Growth in wages has more to do with a tight labor market than with the policy of adjusting the minimum wage.” A tight labor market gives workers more bargaining power in negotiating wage adjustments; a slack labor market would reduce demand for wage adjustments. Given the tight labor market, he says, “Any shock, any additional boost on prices tends to generate inflation. I think there is no way to reduce inflationary pressures in the economy without the labor market cooling off.”

The resilience of employment despite the lack of dynamism in the economy makes it very difficult to predict...
when the labor market might cool off. “We have already seen a slowdown in job creation and some moderation in wage gains,” points out Braulio Borges, an economist at LCA consultancy. He notes that last year the average salary increased just 1.25% above inflation, the lowest in the last three years, according to the Unions Department of Statistics and Socioeconomic Studies. “Unionized workers are those that have greater bargaining power, yet their wages have not increased excessively,” he says. Borges points out that there has been a significant change in the labor supply because of slowing growth of the working age population—estimated at 1.2% annually for 2001–20 compared to 2.3% for 1980–2000—and young people do not seem interested in looking for jobs, a trend Borges thinks needs more study.

**Alternatives**

UFRJ’s Summa argues that policies to curb inflation should not be based on reducing wages, and the current formula for adjusting the minimum wage should be retained. Borges and Matos believe the best alternative would be to formulate a new adjustment rule based on productivity gains, although they recognize that the lack of information about hours worked today makes it difficult to calculate productivity. “The important point is that we cannot give increases in the minimum wage that will generate more inflation than benefits,” Matos says. Mesquita thinks it is time to eliminate a formal rule for raising the minimum wage: “The minimum should again be a decision of the president. The current rule was created to discipline minimum wage increases but has ended up establishing a floor for raising the minimum wage rather than a ceiling.”

Whatever the outcome of the review of the minimum wage adjustment rule in 2015, however, all experts advocate giving more attention to raising productivity. “Among other things, a more open economy, more exposed to international competition would help to raise labor productivity, but in recent years Brazil has moved in the opposite direction,” Mesquita says. “For example, the automotive industry, which has traditionally been very protected, has more protection today than it had in 2010.”

Matos underscores his point: “We need to give incentives for adopting new technologies and improving efficiency, especially in the services sector. Industry is forced to do so when there is international competition, but it is also important for Brazil to encourage this practice.”

“In the absence of measures to increase productivity and the supply of labor, the central bank will have to tighten monetary policy to cool domestic demand and bring inflation down. The therapy is unpleasant, but there will be no alternative left,” Mesquita concludes.

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*Ricardo Summa*

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*Ricardo Summa*
The Brazilian Economy—You have argued that federal, state, and local governments should improve governance. Why?

Augusto Nardes—The protests in the streets last year were the result of government inefficiency—ineffectiveness. Government today is not carried on through the traditional democratic representative structure of three branches of government. Currently society has a direct relationship with the government. … There has been a revolution of social networks, which greatly influence government decisions. This has changed the paradigm...
of how to govern a country. But Brazil is not structured for that. We continue with the traditional analog government even as society has become digital. If we do not invest soon to improve the Brazilian government, we will have social chaos. This process is already happening because the government does not have the capacity to offer adequate health, education, and security services. ... We desperately need a covenant of governance that compels government to deliver to Brazilians quality public services in return for all the taxes and fees we pay.

We must move urgently to show the people that their expectations can be met. For this the Court of Audit is conducting a dialogue with public managers from all states. We have visited 14 capitals to try to sell the idea that states and municipalities have to improve [governance and management]. Why? Because if we do not do something soon, we will have more social problems. For example, the 2013 budget had planned investment spending of around R$180 billion, but less than half was actually disbursed last year because the federal government lacks management capacity.

What has the TCU done to promote better public governance?
We have signed a cooperation agreement with the Organisation for Economic Co-operation and Development so that Brazil can adopt the best governance practices in developed countries by 2016. In November, we plan a major event to point out the major bottlenecks in each sector, especially education, health, and the environment. We are also coordinating with all the state Courts of Audit on important issues—the problem is not only in the federal government. ... The federal government has bottlenecks because its concentration of power hinders the delivery of health, education, and public transportation. ... These services do not work.

How does the TCU see Brazil’s competitiveness?
This year we are concerned with governance. In 2015 we want to evaluate Brazil’s competitiveness. ... We are spending R$455 billion on social security pensions but less than R$90 billion on productive investment. We project that social expenditure will reach 11% of GDP in 2029 and 30% in 2050. We will become a welfare state, but without the capacity to invest in job creation. Saying we have only 5% unemployed while at the same time 70 million people receive some type of government aid is a way to mask the truth. We do need to continue programs like the Family Grant, but we also urgently need to provide better-quality education so that the poor can improve their productivity and incomes. The ideal would be to improve infrastructure to ensure conditions that give the productive sectors incentive to produce more, generate jobs, and pay more taxes.

Have fraud and misappropriation of resources decreased?
The TCU is doing its part. In the last five years we saved R$102 billion. For the World Cup, we saved R$700 million with preventive audits and renego-
tiating contracts. We were being overcharged R$110 million for renovation of Maracanã stadium alone.

Why is there still corruption despite the TCU efforts?
We inspect some of the works, but we cannot supervise all of them. For example, for the 2014 World Cup, we are supervising 200 works of the most important projects but there are 4,000 across the country. TCU is relatively small.

TCU conducted a survey of governance and human resource management in the federal administration and found out that only 7.6% of federal employees are able to carry out their functions efficiently. … In the private sector, the work of employees is continuously evaluated. Brazil has 12 million public employees and most of them are not evaluated, are not even trained, and do not have goals set for their work. … Brazil does not have policies to establish a meritocracy. How can we provide better health, education, environment, and security services if the work of public employees is not evaluated? Citizens pay taxes, expecting good public services, but many public employees only pretend to work.

What about complaints that TCU hinders public works?
Businessmen and congressmen sell that story but it is a myth. We surveyed National Department of Transportation Infrastructure projects and found out that of 1,150 public works about 140 were suspended—but only 2 because of the TCU. Many of those who complain fear transparency. In any case the TCU simply informs Congress of misappropriation of resources and overpricing. The final decision on public works is not TCU’s responsibility. That is up to Congress.

What is your view of the procurement law now being debated?
The streamlined procurement regime of Law 12,462 of 2011 decreased the time to complete a procurement from 240 to 80 days. That is obviously an improvement, but it is still early to make a definitive assessment of the law. We had a debate last year on the 20th anniversary of the 1993 procurement law and recommended that the President of the Senate review it. The report of the commission he established will soon be out and the procurement law may be amended. There have been important improvements, such as the auctions, but we still have more to do. Bureaucracy in Brazil is a major hurdle for foreign investors; the lack of certainty and clarity in procurement discourage investments.

What about state-owned enterprises?
In some sectors government is incompetent—unable to deliver good services. Although in the past powerful vested interests fought privatization of state-owned enterprises (SOEs), today they understand that it is possible to privatize SOEs and have them become more efficient than the government itself. As the TCU continues to evaluate SOEs, we see that some have advanced and others lost ground. … We took too long to address the question of railways, and we are very late with waterways. Most airports will not

“The 2013 budget had planned investment spending of around R$180 billion, but less than half was actually disbursed last year because the federal government lacks management capacity.”
be ready for the World Cup. There was a lack of planning, though TCU warned municipalities, states, and the federal government that it was necessary. Again, the problem of governance and management in Brazil is a national problem. That is why I argue for a governance covenant, and for this we must work together with all parties.

Many states and municipalities have high debts that breach the Fiscal Responsibility Law. Could better governance alone solve this?

If we do not make a new federative covenant, we will continue with this unequal situation where the federal government holds most of the resources at the expense of municipalities and states. I visited the Northeast region and some municipalities there fail to comply with the Fiscal Responsibility Law because they do not themselves generate wealth. In Alagoas and Bahia states, there are municipalities where more than 50% of the population is dependent on the Family Grant program. How do states comply with the law if they do not have income and depend on federal aid? Without a new covenant to create a balance between states, municipalities, and federal government, in the short and medium term many municipalities will become insolvent.

This is a thorny issue. Political agreement is necessary. We need great statesmanship to build it. Political leaders should put the interests of the people above party interests. … We have seen mayors resigning because they have no power to collect enough taxes to meet the needs of the population. … But if governance is not good, a federative covenant is of no use. They are closely linked. We need to evolve culturally and make it clear that population needs come first. Political parties need to be aware that it is more important to negotiate a project for the country than a project for their own party.

What does the TCU think of public sector “creative accounting”?

We must work to meet international accounting standards. “Creative accounting” is extremely negative; it costs the country international credibility. The TCU preaches that to have credibility, Brazil must meet international standards of auditing and accounting.

“Saying we have only 5% unemployed, while at the same time 70 million people receive some type of government aid is a way to mask the truth.”

What is the Court of Accounts of the Union (TCU)?

The Court of Accounts of the Union (often referred to as TCU) is the Brazilian federal accountability office. It is an independent federal agency that works for Congress like the US Government Accounting Office. It supports the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government. Its members are appointed by the National Congress and the President of Brazil. The TCU employs a highly qualified body of civil servants to prevent, investigate and sanction corruption and malpractice of public funds, with national jurisdiction. The TCU cooperates with the Comptroller-General of the Union (CGU), which centralizes federal executive internal audit, and its operations are scrutinized by the Attorney General’s office.
In addition to producing and disseminating the main financial and economic indicators of Brazil, IBRE (Brazilian Institute of Economics) of Getulio Vargas Foundation provides access to its extensive databases through user licenses and consulting services according to the needs of your business.

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Brazilian economy on hold

APRIL BROUGHT LITTLE new in terms of short-term performance and prospects for the Brazilian economy. The outlook is at best lukewarm, with little change from the last month in terms of industrial production, investment, and inflation.

The release in April of the revised results for the Monthly Survey of Physical Production by government statistics agency IBGE revealed that industrial growth in 2013 was better than previously thought: as revised, industry growth almost doubled, from 1.2% to 2.3%. Most industries showed better performance after the revision, but not capital goods, which worsened. However, despite the upward revision for 2013, industrial growth in the first quarter of this year is not encouraging, considering that production fell 0.4%. The outlook for economic activity for the months ahead is also far from encouraging.

While business confidence has been falling since the year began, the April result draws attention because of the intensity of the decline and its spread to more industrial sectors. The private sector opened the second quarter at a slow pace and seems skeptical about the possibility of the outlook changing in three to six months. The loss of confidence is also affecting investment prospects: the IBRE-FGV Investment Confidence Index, which monitors producers of fixed capital, fell by 6.7% in April, the steepest drop since January 2009.

Despite the expected slowdown in food prices in the near future, inflation is being pressured by many other factors, and in the second quarter it may even breach the government target ceiling (6.5% year-on-year) for inflation. The continued rise of non-controlled services prices is behind the stubborn resistance of inflation to falling, despite recent increases in the central bank benchmark interest rate.

Brazil’s investment confidence declined severely in April.*

(Seasonally adjusted, quarterly moving averages, average last 5 years=100)

Source: Brazilian Institute of Economics (IBRE).

*Weighted aggregation of construction industry, construction materials, capital goods industry, and engineering services confidence indexes.