

# Why investment is still tied up

**The federal government's limited capacity to carry out investments undermines its ability to boost economic growth. Enter private enterprise?**

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THE BRAZILIAN economy's downturn earlier this year was worse than expected and the government's incentive programs have had little visible effect on the economy. The lost growth in the first half of the year has turned attention to one of the shakier pillars of the economy: investment.

With the end of the cycle of durable goods purchases by Brazilian households and with an adverse international scenario discouraging any increase in manufacturing investment, the great sporting infrastructure works have become the focus of attention as a lifeline to boost economic activity and increase economic competitiveness in the medium term. The timing, however, could not have been worse: so far in 2012 federal government execution of budgeted infrastructure has been below expectations, in part because key institutions have been weakened by accusations of corruption. The main problem is the Ministry of Transport and its principal agency, the National Department of Transport Infrastructure (DNIT), where, according to statements by Minister Paulo Sérgio Passos, changes in personnel have not yet been completed.

"The Ministry of Transport's execution of the investment budget in the first half of the year was 0.17% of GDP—below the 0.31% of GDP in 2010 and 2011 and very close to the average for 2006 to 2008," says Samuel Pessôa, consultant to the Brazilian Institute of Economics. With this meager investment rate, there is not much hope of saving the economy.

Federal public works under the Growth Acceleration Plan (PAC) have been equally feeble. "At its peak the PAC has meant an increase of only 0.5% of GDP in infrastructure investments . . . far below the desirable level," says economist Claudio Frischtak of Inter.B consultants. "When the PAC was launched in 2007, the expectation was that it would bring much more frequent diagnosis of government investment projects, facilitating the correction of problems. That did not happen," points out economist Mansueto Almeida, a specialist in public accounts with the Institute of Applied Economic Research (IPEA).

The Roussef administration seems to recognize that the leisurely pace of adjustments in the public administration despite the need for rapid response is a problem and is now calling on the private sector to participate in the solution. After a burst of the Keynesianism of Finance Minister Guido Mantega, who has called on entrepreneurs to invest, the expectation is now that the government will come up with a package of concessions for roads, railways, ports, airports, and power projects.

The initiative is not just welcome, it is necessary. "The country needs

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investments in concessions and public-private partnerships (PPPs) . . . But we failed to do more and learn from them, to release resources for other important public works," says Julio Almeida, consultant to the Institute for Studies in Industrial Development. Pessôa observes that "The government does not have resources to raise public investment in infrastructure to 4%, 5% of GDP. Government investments are about 1%, states and municipalities another 1%." Frischtak emphasizes that Brazil must take advantage of this opportunity to attract investments while the window is still open.

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Among the problems with investments that analysts identify is the lack of long-term planning, the result of decades without the country undertaking any large infrastructure projects. "Today the country has specific programs, but not exactly a plan with a strategic vision," says former Planning Minister João Paulo dos Reis Velloso, president of the National Forum of the National Institute of Advanced Studies. From his years of experience as coordinator of two development plans in

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the '70s, a time when the country invested 25% of GDP and grew 6% a year, he responds impatiently when asked about the exhaustion of the economic model based on consumption. "Nothing begins with consumption; it begins with public and private investments that generate employment and income. If not, the inevitable occurs: increasing debt, default, banks panic, and the bubble bursts."

Yoshiaki Nakano, director of the São Paulo School of Economics of Getulio Vargas Foundation, agrees that the lack of a strategic plan is reflected in the quality of investment projects: "All activities that are crucial for development of projects and their implementation were deactivated." Projects of poor quality are barred by the Court of Audit or by delays in acquisition of environmental permits, slowing their execution. However, says Almeida, "We have many requirements for public sector projects that are correct. Sometimes there are excesses, but in general delays reflect an inability of the public sector to carry out projects." Pessôa adds, "It's worth spending much more time with the project design because it is cheap, equivalent to 5% of the total cost. Imagine doing a good project

**Brazil: Investment in infrastructure**

(Billions of reais)

| | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| Federal government | 11.4 | 14.6 | 19.1 | 22.9 |
| % of GDP | 0.43 | 0.48 | 0.60 | 0.62 |
| State-owned companies | 18.2 | 23.9 | 33.7 | 32.9 |
| % of GDP | 0.68 | 0.79 | 1.06 | 0.90 |
| Private companies | 24.9 | 41.7 | 32.8 | 37.2 |
| % of GDP | 0.94 | 1.38 | 1.03 | 1.01 |

Source: Inter.B.

and saving 20%. The fact is that we do not have in the public sector . . . an excellent institutional framework to choose projects. This is a major bottleneck."

To change this reality, however, implies making far more delicate changes, those related to the high degree of politicization of public offices. "We have an excess of appointed positions compared to career civil servant technicians. Thus, the possibility of each new government starting from scratch is high," says Francisco Gil Castello Branco, secretary general of Open Accounts, an NGO. This opinion is supported by former Minister Velloso, who says that "In the '70s, we had 15 ministries; today we have 40."

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**Brazil: Investment in infrastructure by sector**

(Billions of reais)

| | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| Eletric power | 18.7 | 21.1 | 23.8 | 27.3 |
| Telecomunications | 12.4 | 24.3 | 18.2 | 16.6 |
| Roads | 11.0 | 15.8 | 22.4 | 28.6 |
| Railways | 2.7 | 4.3 | 2.7 | 3.0 |
| Subway transportation | 1.2 | 2.5 | 5.1 | 3.0 |
| Airports | 0.6 | 0.4 | 0.4 | 0.6 |
| Ports | 1.0 | 1.3 | 1.7 | 2.1 |
| Waterways | 0.3 | 0.4 | 0.6 | 0.7 |
| Sanitation | 6.6 | 10.2 | 10.6 | 11.0 |
| Total investment in infrastructure | 54.5 | 80.3 | 85.6 | 93.0 |
| Nominal GDP | 2,661 | 3,032 | 3,185 | 3,675 |
| Investment (% of GDP) | 2.05 | 2.65 | 2.69 | 2.53 |

Source: Inter.B.

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*João Paulo dos Reis Velloso*

### CREAKY BUREAUCRACY

The private sector laments the lack of efficient public sector management and the excess of red tape. Nakano says outright, "What we need is reform of public administration. The Brazilian bureaucracy is still at the standard of the nineteenth century. It has no concern for cost or regard for results. There is no oversight, [and there is] very limited implementation capacity."

Renato Poltronieri, partner, Demarest e Almeida Advogados, says that for his clients who have contracts with the government, the major obstacle is the lack of political will to accelerate decisions. "In 2008, we prepared a study on the situation of Brazilian airports, commissioned by

## Public-private partnerships welcome

It is evident that the government is unable to invest and carry out the public works necessary for the country to grow. One solution is cooperation between the private and the public sectors to provide essential infrastructure. "With the current lack of [public] infrastructure investment, granting concessions and establishing public-private partnerships [PPPs] can be an alternative for the government to try to close the [investment] gap," says Ronald Munk, Accenture head of health and public services.

Established by law in 2004, PPPs are still in an embryonic stage due to lack of interest or even knowledge by both public and private entities. Nevertheless, Munk believes that PPPs should be pursued and may even help improve management of the public sector: "It is necessary that we have effective leadership in government who want to make changes, have a more modern approach to management, and view collaboration between the public sector and private companies not as a necessary evil, but as welcome opportunities."

However, experts are unanimous that if this is to be a viable alternative, it is necessary that there be more understanding of PPPs and better design of their contracts. "You can build a lot of wonderful roads that become useless white elephants and bankrupt the government," said Samuel Pessôa, consultant to the IBRE, who thinks that until now PPPs in Brazil have been a disappointment.

the National Bank for Economic and Social Development; only in 2012 did the government grant airport concessions to the private sector. Four years of waiting . . . ," he says. "All major projects carried out today are from the '70s. And others, like the bullet train project, seem administrative caprices because of the quality and high cost of the project."

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*Yoshiaki Nakano*

### NOW OR NEVER

Despite the uncertainties, there is optimism about the expected government announcement of the package of concessions. Recent experience with three airports—Brasilia, Guarulhos, and Viracopos—has been positive. "It is not a simple process . . . the combination of risk and return cannot be too favorable to one side or the other. If it is very favorable for business, prices are very expensive; if unfavorable, no one invests," says Almeida.

## Doing more with less

Brazilians no longer accept government claims that progress is crippled because a lack of resources undermines investment. Perhaps this is why some municipalities, states, and even federal agencies are seeking ways to do more with less, focusing on management improvements. "There's been a quiet revolution in the country. Governments at all levels are seeking the same management tools used successfully in the private sector," says Erik Camarano, CEO, Movement for Competitive Brazil (MBC). The MBC is a private organization that helps the public sector to balance its budgets and regain the ability to invest, which leads to gains in efficiency and competitiveness for the country.

Because the Brazil Cost affects private companies, Camarano explains, MBC works on five fronts—strategic planning, expenses, project management, redesign of processes, and revenues—and results come quickly: "In the projects we carry out, in general, revenues increase and expenses fall in the first six months." Between 2005 and the first half of 2011, 25 public entities assisted by MBC reported profits of R$14 billion and investments of R$79 million.

The gains are not just financial. For example, the Pact for Life program in Pernambuco state, through better management tools and design goals, achieved positive results in safety, health, and education.

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Carlos Campos Neto, IPEA coordinator of Economic Infrastructure, says that regarding airport concessions, there is a clear maturing process. "It's the first time that airport concessions were granted in Brazil . . . these concessions have positive aspects in seeking to ensure the quality of service and comfort to the users," he says.

According to Frischtak, for new concessions to succeed, "We need depoliticized regulatory agencies." He also insists on the need for long-term planning, adding "We also need commitment from the government and Congress that the infrastructure sector will remain open to private initiative in coming years." Frischtak cites the energy sector as an example not to be followed, explaining that "The pricing policy today is highly distorting. By controlling fuel prices the government is damaging the prospects of investment in the energy sector."

Even with a discouraging outlook for 2012 and delays in the works for the major sporting events Brazil will host, Gabriel Leal, IBRE, thinks that today the government has a unique opportunity to reverse the outlook for next year: "We must recognize that the Rousseff administration demonstrates the intention to improve. The President is articulating international agreements and working groups to develop a metric for evaluating public policies, has created a supersecretariat for public management, and gathered big businessmen in a committee to assist in the evaluation of projects (Committee of Management Policy, Performance and Competitiveness) based on the model developed in 2001 by former British Prime Minister Tony Blair." Frischtak adds, "The political decision to get something done is positive. The media, the pressure of civil society, and the Court of Audit can help the government to improve the quality, design and implementation of projects." IPEA's Mansueto warns, however, that we cannot lose more time. "Granting concessions in infrastructure to the private sector was held up for half a decade, and the result we now see in the hustle and bustle for sporting events," he says. "Moreover, the entrepreneur is rational and moves by profit, not by kindness," he adds, suggesting that mishandling and delays of new concessions could leave the government alone in investing in infrastructure.