THE BRAZILIAN ECONOMY

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There are still no definitive signs of a lasting recovery

Interview
Luiz Fernando Furlan: Brazil needs a better business environment

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Regional Economic Climate
The economic climate in Latin America and Brazil is worsening

WHERE IS THE LABOR MARKET HEADING?

The labor market is correcting the excessive growth that was inconsistent with the pace of economic expansion. Is the policy to curb inflation going to affect adversely the gradual accommodation of the labor market?

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The BRAZILIAN ECONOMY

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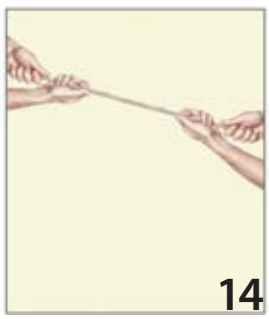
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THE BRAZILIAN ECONOMY









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Because there is a prospect that Brazil's currency will stay weak for the foreseeable future, positive changes to energy and trade policies that were already underway are starting to speed up. For instance, João Augusto de Castro Neves explains, on trade, a weaker *real* means that the government is already less willing to enact more protectionist measures.

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The labor market is correcting the excessive growth that was inconsistent with the pace of economic expansion. The question is whether policies to curb inflation and wage increases may adversely affect the gradual accommodation of the labor market and bring about deterioration in incomes, employment, and confidence. Solange Monteiro solicits opinions from the experts.

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Workers, employers, legislators, jurists, and government all agree that Brazil's 70-year-old labor law needs reforms to align it with those of other countries. However, it is difficult to identify which points to reform. Experts, both pessimistic and optimistic, discuss the problems with Kalinka Iaquinto and identify what should be priorities.

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20 Brazil needs a better business environment

In the 10 years since his service as Minister of Development, Industry and Foreign Trade in the first term of former President Lula, Luiz Fernando Furlan believes that Brazil has recorded important achievements, but he adds that "We are prolific in diagnostics and announcements but meager in delivering results." He tells Solange Monteiro that "the Brazilian market is still attractive" to investors, but calls on businesspeople to be "impatient" in pushing for changes to make it more so.

Regional Economic Climate

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IBRE Economic Outlook

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ECONOMY

Chinese auto plant to open soon

Privately owned Chinese automaker Chery will open its new plant in Jacarei city in São Paulo state this year, the company has announced. Construction began in 2011 with an investment of US400 million. Chery already has 80 dealers in Brazil, one of its top markets, and with a domestic plant, it will pay less tax, making its products more competitive. (August 11)

Accelerated growth in second quarter not expected to last

In the second quarter Brazil's economy grew at its fastest in more than three years, but with rising interest rates, among other problems, many expect little to no growth in the second half of 2013. GDP grew 1.5 percent from the first quarter, government statistics agency IBGE said. Investments, as measured by gross capital expenditure, rose for a third straight quarter, gaining 3.6 percent over the previous quarter. (August 30)

Industrial output retreats in July

Brazilian industrial output fell more than expected in July as capital goods production dropped by a seasonally adjusted 2.0% from June. IBGE also revised the June data upward from a 1.9% increase to a 2.1% increase. Of 27 sectors surveyed, 15 declined in July, notably automobiles, pharmaceutical goods, and rubber and plastic products. In broader industrial categories, consumer goods fell 2.6% and intermediate goods 0.7%. (September 3)

Trade balance worst in 18 years

In August, at US$1.2 billion the trade surplus was 62% lower than the US$13 billion surplus in August 2012. Since January the 2013 trade balance has recorded a deficit of US$3.7 billion. (September 2)

Brazil ranked as less competitive

Brazil is ranked 56th in the *Global Competitiveness Report 2013-2014*, down from 48th for the previous year. It has been overtaken by not only Mexico, Costa Rica, and South Africa but even Portugal. The drop reflects the negative combination of rising inflation, low growth, high debt, rising external deficit, and lack of significant investments in infrastructure and of tax simplification. (September 3)

Services sector shrinks for first time in 12 months

The closely watched HSBC Purchasing Managers Index for Brazilian services fell to 49.7, seasonally adjusted, in August from 50.3 in July; readings above 50 indicate expansion. http://www.hsbc.com/news-and-insight/emerging-markets. (September 4)

Stock market up

The Ibovespa ended August at 50,011 points, up 3.68% from July. In August 2013, financial volume on the exchange totaled a record R$187 billion in, also a record, 21,736,691 trades, up from R$133 billion and 18,355,701 trades in July. (September 5)

Inflation up 0.24% in August

The National Consumer Price Index (IPCA) rose 0.24% in August, IBGE reported. For the 12 months ending in August, inflation was 6.1%. (September 6)

SOCIETY

Population to top 200 million

Brazil's population will move past 200 million in 2013, an IGBE study based on census data has found, and will continue rising longer than expected as members of the expanding middle class live longer than their parents. Population will peak at 228 million in 2042 before stabilizing at about 218 million in 2060. The fertility rate has plunged since the 1970s, from an average of 4.0 births per woman to the current 1.77. In 2034, the rate will fall to 1.5 and stay there through 2060. However, life expectancy has also been growing, to an average 71.3 years for men and 78.5 years for women. (August 29)

JUSTICE

Supreme Court hears appeals of convicted former officials

The Supreme Court on August 21 opened hearings on the appeals of former officials of President Lula (2003–10) convicted of corruption in October 2012. Of 38 people accused, 25 were found guilty of taking part in a scheme to divert public funds to buy political support. All 25 have appealed their jail terms and fines. On August 23 the Supreme Court flatly rejected the appeal of Delubio Soares, former treasurer of the ruling Workers' Party (PT). (August 21 and 23)

FOREIGN POLICY

Foreign policy ministerial shake-up

After members of his diplomatic staff smuggled a Bolivian opposition politician into Brazil, in an incident that challenges Brazil's neutrality policy, Foreign Minister Antonio Patriota was replaced by Brazil's ambassador to the United Nations, Luiz Alberto Figueiredo. Bolivian senator Roger Pinto, who says he received death threats after accusing his government of links to drug traffickers, was taken from the Brazilian embassy in La Paz and driven over the border. Patriota has assumed Figueiredo's UN duties. Mr. Figueiredo was Brazil's lead negotiator on climate change until he moved to the UN post a year ago, but few expect him to have much more influence than his predecessor. (August 26)

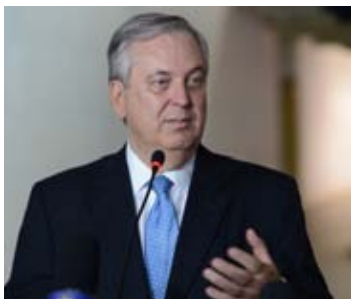


Photo: Fabio Rodrigues Pozzebom/ Agencia Brasil.

New Foreign Minister Luiz Alberto Figueiredo.



Photo: Antonio Cruz/Agencia Brasil.

New UN Ambassador Antonio Patriota

ECONOMIC POLICY

Record disbursements leave BNDES short

Brazil's National Bank for Economic and Social Development (BNDES) said it needs more capital to fund this year's record loan disbursements. Bank president Luciano Coutinho said that the BNDES may ask the national treasury, its largest shareholder, for a capital injection or borrow money in domestic debt markets in the fourth quarter. Brazil's main source of long-term corporate credit, BNDES is expected to disburse US$80 billion this year. (August 14)

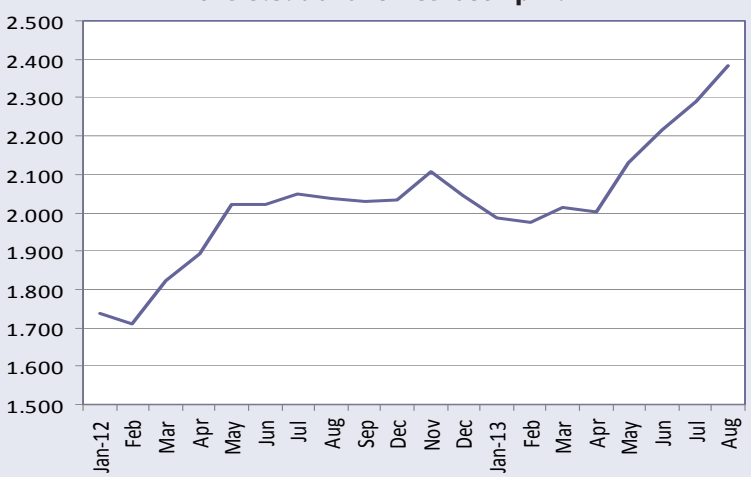
US$60 billion central bank currency intervention

By year-end the central bank will provide US$60 billion in cash and insurance to the foreign-exchange market to bolster the *real* as it slips to a near five-year low against the dollar. The bank will sell US$500 million worth of currency swaps, derivative contracts designed to provide investors with a hedge against a weaker *real*. (August 22)

Benchmark rate up

In a move to restore investor confidence and curb inflation, the central bank monetary policy committee said in its announcement, it raised the benchmark rate by 50 basis points to 9%, bringing total tightening up to 175 basis points since April. The Brazilian *real* has depreciated more than 20% against the dollar since last April, pushing up both the cost of imports and already high inflation. (August 28)

Brazilian real has devalued 20% against the U.S. dollar since last April.



Source: Central Bank of Brazil.

July public sector deficit worst since 2002

The Brazilian government's nominal deficit reached R$21.1 billion Brazilian *reais* (US$8.97 billion) in July, up from R$12.2 billion in June, the worst record in more than a decade. For the last 12 months, the deficit was R$138.7 billion—3% of GDP. Brazil's fiscal deficit has become a major issue recently as economic growth stalled and the government used accounting gimmicks to minimize the deficit. (August 30)

FGV Brazil

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FGV

Barriers to jobs for young people

ALTHOUGH TOTAL UNEMPLOYMENT, while starting to trend upward, remains low at 5.6%, unemployment in Brazil among young people is still unacceptably high at 14.7%. That's the result partly of our very rigid labor legislation and high payroll taxes, and partly of the failure of the educational system to train young people in the skills employers are looking for.

Brazil is not the only country with many young people leaving school and unable to find work. Nor is it the first. Here, we can learn a lot from an initiative Germany undertook ten years ago. In March 2003, when Chancellor Gerhard Schroeder proposed a package of labor market reforms called Agenda 2010, more than 11.6% of the German workforce was unemployed, and among youth the rate was 16%. A widespread assumption was that unemployment could never be defeated, only managed. Agenda 2010 undertook to make Germany's labor market more flexible. It allowed small businesses to fire more easily, which lowered the cost of hiring. It liberalized rules for part-time and temporary work. Above all, it merged two types of benefits—federal assistance for the unemployed and municipal welfare payments—into one guarantee of a basic living standard. Ten years later total unemployment is 5.4% and youth unemployment is 7.7%.

One factor that had long been in place in Germany was a pragmatic educational system that, unlike Brazil's, emphasizes vocational training and company apprenticeships, and another was a much lower rate of informality in the labor market. Brazil also suffers from structural incentives for worker turnover, specifically the unemployment insurance system, which also discourages firms from investing in training for their workers.

One factor that had long been in place in Germany was a pragmatic educational system that, unlike Brazil's, emphasizes vocational training and company apprenticeships, and another was a much lower rate of informality in the labor market.

Experts on the labor market generally agree on the need for reforms in education, not only to prepare students for the working world but also to make it more attractive for them to apply themselves in school and to stay there to graduate. They are similarly agreed on the need to loosen the rigidity of the labor market and reduce payroll taxes. But not much has been done, because there is opposition from a variety of interest groups. Unions, for instance, are financed with a universal levy on formal workers, rather than member fees, which means that for all practical purposes they are not accountable to their members. Meanwhile, all those pushing their own interests are holding hostage the possibility of true economic growth, which though perhaps less obviously would ultimately be greatly in their own long-term interests.

A year ago the Inter-American Development Bank published a report on "Structural Reforms in Brazil:Progress and Unfinished Agenda" that contained a section on labor market policies. There the IDB may have identified the most basic problem of all: "Needed labor market reforms do not appear to figure in the agenda of the current government."

There's a silver lining in Brazil's weak currency

João Augusto de Castro Neves, *Washington D.C.*

THE BRAZILIAN *REAL* IS ONE of the worst-performing emerging market currencies this year, having fallen more than 20% against the dollar since January. While the Central Bank has announced some interventions in the foreign-exchange market, the government has few tools to bolster the currency considering that global liquidity is likely to diminish after the U.S. unwinds monetary easing.

Considering that not only the government in Brasilia but also investors are increasingly concerned about Brazil's growth and policy outlook, the prospect of the currency staying weaker for the foreseeable future is starting to accelerate positive changes to energy and trade policies that were already underway.

On trade, a weaker *real* means that the government is already less willing to enact more protectionist measures. In July Brasilia decided not to renew the tariffs on 100 products that were raised last year; they represented about 4% of Brazil's total imports. The decision was driven mainly by concerns about the rising costs of inputs to industry. Earlier this year, Minister of Finance Guido Mantega had announced that the government was going to lower import tariffs in order to fight inflation. While some sectors of local industry will continue to demand protection from imports, the current economic environment is likely to diminish government responsiveness to the demands.

The government has few tools to bolster the currency considering that global liquidity is likely to diminish after the U.S. unwinds monetary easing.

More meaningful changes to Brazil's trade negotiation agenda, however, are unlikely in the short term. The country has logged a trade deficit of almost US$4 billion this year through August—the worst result since 2001. The possibility of a slowdown in Chinese growth may exacerbate the situation, given the likely impact on commodity prices and the fact that China is now Brazil's main trading partner.

Despite persistent disputes within the bloc, so far Brasilia continues to be very committed to Mercosur. But a more challenging global economic environment, coupled with such US-led trade initiatives as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, is likely to push Brazil to review its trade policy in the next few years.

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The weaker currency is likely also to have a less obvious consequence—on energy policy. Much of the attention in terms of energy justifiably focuses on one prominent victim of a depreciated currency, the state-controlled oil giant Petrobras. With the *real* much weaker than it anticipated in its 2013 business plan, the company has to shoulder the cost of an even wider gap between international oil prices and domestic fuel prices. The burden will continue as the government's concern about inflation increases and is likely to worsen as the company prepares for its role as lead operator in the first deep sea oil auction in October; the company is expected to pay at least 30% of the minimum signing bonus of R$15 billion (about US$6.5 billion) stipulated by the government.

As fuel pricing policy remains constricted and operational and financial constraints on Petrobras grow, the odds of the government altering its policy on deep sea oil production will rise. In addition to concern about Petrobras capabilities, two other reasons seem to be driving the likely revision of the policy. The first is a frustratingly tepid economic recovery in 2013, which is pushing the government to place a larger premium on enacting measures to ensure a pipeline of investments to drive a more robust recovery. Lifting Petrobras obligations on all new deep sea oil would allow the government to give international oil companies more opportunities to participate on an equal footing. The government, for example, could very well announce a second round of bids for 2014 if the restriction that Petrobras must be lead operator is lifted.

While some sectors of local industry will continue to demand protection from imports, the current economic environment is likely to diminish government responsiveness to the demands.

The second reason is the technological revolution that has occurred in the global energy market in the last several years, thanks to expanded production of shale gas and tight oil in the US. This, along with proposed energy reforms in Mexico and elsewhere, has somewhat diminished Brazil's leverage in global energy markets.

The idea that Brazil won a lottery ticket with the discovery of the deep sea oil reserves may still be true. But in an ever-changing and highly competitive world, it is becoming more evident that the prize has an expiration date.

As fuel pricing policy remains constricted and operational and financial constraints on Petrobras grow, the odds of the government altering its policy on deep sea oil production will rise.

WHERE IS THE LABOR MARKET HEADING?

The labor market is correcting the excessive growth that was inconsistent with the pace of economic expansion. The question is whether policies to curb inflation and wage increases may adversely affect the gradual accommodation of the labor market and bring about deterioration in incomes, employment, and confidence.



Solange Monteiro, *Rio de Janeiro*

ALTHOUGH IN RECENT YEARS, BRAZIL HAS MAINTAINED full employment despite the economic downturn, in the first half of 2013 the labor market began to show clear signs of exhaustion, and projections for the whole of 2013 are now less favorable. Currently, although at 5.5% the unemployment rate is the same as in 2012, the numbers behind the percentage suggest that the labor market is indeed worsening.

The adjustment of the labor market, although expected, still raises questions. Carlos Henrique Corseuil, deputy director of social studies and policies, Institute of Applied Economic Research (IPEA), says that "on one hand, employment and wages are stagnant. This means that we cannot rely much on wages as an engine for growth and expansion of future employment. On the other hand, quarterly GDP growth seems to indicate a recovery of economic activity. With these forces pulling in opposite directions, it is difficult to make a definitive forecast." Fernando de Holanda Barbosa Filho, researcher, Brazilian Institute of Economics (IBRE), sings a similar tune: "The decline [in employment] may well be accompanied by a cyclical downturn—how deep or how long it will last is difficult to predict as yet." Although the labor market slowdown will increase the number of people without jobs, it will help curb inflation, which erodes the purchasing power of Brazilians.

GRADUAL CHANGE

The change in the labor market is not sudden. Job vacancies have been declining since mid-2011. However, in recent months, data on key indicators of industry have revealed two major imbalances. The first was a reduction in real wages for hiring and firing, as well as average real income in the first half of the year. "This was partly due to rising inflation," says economist Fernanda Guardado of Brazil Plural bank. "In this context, wage recovery will also be affected. Actual gains of the order of 3–4%, as in the past year, will be much harder," she says.

The second indicator shock occurred in June and July, when for two consecutive months the labor supply (= the economically active population) grew faster than job vacancies, interrupting the dynamic that had been helping to support high employment despite low economic growth. Guardado points out that between 2004 and 2008 the labor supply grew 1.7% a year but job vacancies increased 2.7% a year, which meant a significant reduction in unemployment. "To maintain stable employment, the country needs to generate 62, 000 formal jobs. Today, however, it is generating only 47,000," she says.

Two IBRE surveys have also showed labor market conditions worsening. The employment leading indicator (IAEmp) fell by 5.7% in July, the largest decline since November 2008. Meanwhile, the coincident unemployment indicator (ICD), which reflects consumer concern about unemployment, went up 7.2%.

Although the labor market slowdown will increase the number of people without jobs, it will help curb inflation, which erodes the purchasing power of Brazilians.

Flávio Castelo Branco, executive manager of economic policy, National Confederation of Industries (CNI), points out that "In recent CNI surveys, job creation was down 50 points, which we consider negative. The trend for the next six months shows a slight improvement at 51 points in August, but that does not suggest much strength." Castelo Branco notes that some sectors, such as textiles, leather, and footwear, are more exposed to international competition; and for others the problems are more related to the economic cycle of investment, such as machinery and equipment. Both groups have reported job losses. Castelo Branco also points out that the payroll tax relief given by the government has not met expectations.

The Institute for Studies in Industrial Development (Iedi) points out that in the first six months of the year, industrial production grew by 1.9% but employment in manufacturing fell 0.7%, indicating a mismatch between production and employment. This could be partly due to an automation trend in industry, according to Júlio Gomes de Almeida, Iedi consultant. He believes that the 3.8% increase in

The payroll tax relief given by the government has not met expectations.

employment in the construction sector may be offset by lower employment growth in the service sector.

Driven by consumption expansion in recent years, services have been the major force for hiring. "[The sector] was growing at 10%, but now the sector is reaching maturity, matching GDP growth," says Fabio Pina, economic adviser to the Federation of Commerce in Goods, Services and Tourism of São Paulo state (Fecomércio). In the second quarter, in fact, services registered growth of only 0.8%, while GDP grew by 1.5%. Since it is "no longer able to absorb as many of the 1.5 million people who enter the labor market annually," Pina says, "lower hiring in the service sector will certainly increase unemployment." Conversely, less hiring for services will reduce the pressure on industrial wages. Part of industry's loss of competitiveness was due to rising wages based on growth in the service sector.

EYE ON INFLATION

Despite future uncertainty, at least in the short term a higher unemployment rate should not be so intense as to cause social unrest. The expectation is that the labor market is correcting excessive growth that was inconsistent with the pace of economic expansion. "If you want to control inflation, which in Brazil is primarily service sector inflation, unemployment will have to increase," says José Marcio Camargo, of Opus Investment Management. The question, however, is how to calibrate the cooling of the economy with wages, since the recent step exchange rate devaluation has caused an inflationary shock that may adversely affect the gradual accommodation of the labor market, bringing about deterioration in incomes, employment, and confidence. In general, analysts think that for 2013 the government will allow unemployment to increase and leave the Central Bank free to increase the interest rate. The government objective would be to stabilize inflation before the presidential elections in 2014.

The government's focus should be on controlling inflation and increasing productivity to ensure sustainable employment. "Our problem, especially for industry, is high costs. If the exchange rate devaluation holds and there is a change in relative prices, you might see an improvement in competitiveness, but this is not a very stable framework," says Castelo Branco. "We need shocks of competitiveness and productivity . . . a

"To maintain stable employment, the country needs to generate 62, 000 formal jobs. Today, however, it is generating only 47,000."

Fernanda Guardado

supply shock through investments," he says, noting that a productivity gain can offset increases in wages.

According to Iedi's Almeida, sustaining more robust growth, as was recorded in the second quarter, would be a good start. Controlling inflation better and avoiding excessive exchange rate volatility would also help. And "a good private sector response to the auction of deep sea oil and concessions for infrastructure would also boost business confidence." The government should avoid boosting domestic consumption to reduce unemployment. "We need a competitive shock through more structural reforms, not policies that encourage more consumption, like those in the last two years," Castelo Branco says.

"If you want to control inflation, which in Brazil is primarily service sector inflation, unemployment will have to increase."

José Marcio Camargo

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Labor law in need of reform



Kalinka Iaquinto, *Rio de Janeiro*

THE LAW GOVERNING THE LABOR MARKET in Brazil has been the subject of discussion for decades. Workers, employers, legislators, jurists, and governments all agree that Brazil's 70-year-old labor law (CLT) needs reforms to align it with those of other countries. However, it is difficult to identify which points to reform. In Brazil, labor reforms, especially legal, induce insecurity; they affect not only relations between employers and workers but also the economy as a whole.

"More and more, investors are aware of the difficulty of predicting what will happen. Some say that in Brazil even the past is not predictable," says José Pastore, professor in the Economics and Business Department, University of São Paulo. In Brazil, changes in the law can often have retroactive effects. Examples are the changes made in 2011 in the law of prior notice (Law 12,506), which substantially increased severance costs because employees with up to one year of employment who are laid off are entitled to 30 days notice or indemnity, plus three days for each additional year of service, up to a total of 90 days

Businesspeople agree with Pastore. Alexandre Furlan, chairman of the Labor Relations Council of the National Confederation of Industry (CNI) added that labor law in Brazil is too subjective and does not actually protect those who really need protection. That point was picked up by Luiz Guilherme Migliora, professor of labor law at the Getulio Vargas Foundation (FGV), who noted that "Our laws [give] the same level of protection and official procedure for everyone, from the factory floor worker to employees in executive positions." He noted that "Current law causes uncertainty, which generates expenses that raise the overall

cost of doing business." Migliora estimates that on average for every R$1 paid to the employee, the employer is actually paying out R$1.54 to R$1.65.

Resistance

Pastore believes that labor reforms are necessary to boost competitiveness of the Brazilian economy as a whole and enhance job quality. Though he agrees that labor reforms are needed, Fernando de Holanda Barbosa Filho, researcher for the Brazilian Institute of Economics (IBRE) is pessimistic that anything will be done: "We tried to reform the labor laws when unemployment was 14% and reforms were rejected. With unemployment at 6%, certainly no one will accept it."

Clemente Ganz Lúcio, technical director, Department of Statistics and Socioeconomic Studies (Dieese), advocates constant upgrading of labor laws to keep them current with the transformations in the world and society's, but he points out that "many times the corporations want to cut back workers' rights" and comments that "if reform means job instability or less workers' rights, there is no union support."

CNI's Furlan thinks that is too pessimistic. He explains that recommended changes that CNI presented to the government last December take into account the preservation of workers' rights guaranteed by the Constitution and law, but also deal with issues related to productivity and business competitiveness in a fast paced globalized economy with new technologies. "The world has changed and we are lagging behind. Today, the legal situation is different from what existed 70 years ago," he adds.

"Today's union leaders do not want to change the system because they have easy money and a guaranteed monopoly."

Ives Gandra da Silva Martins Filho

One concept that underlies Brazilian labor law is that the worker is the weakest party in negotiations and must be protected. Yet both employers and employees agree that this is not necessarily so. "The labor law was implemented in a context where the government controlled negotiations between corporations and labor," says Artur Henrique da Silva Santos, assistant secretary of international relations, Workers' Central Union (CUT). He advocates greater autonomy and the

Brazil payroll taxes are high, adding as much as 65% to the cost of hiring a worker.

13th monthly salary	8.3%
Paid vacations	8.3%
Vacation bonus	2.8%
Guarantee Fund for Time of Service (FGTS)	8.0%
FGTS fine	4.0%
Social Security tax (INSS)	27.0%
Other taxes	6.8%
Total	65.3%

Source: Luiz Guilherme Migliora, FGV.

Shorter workweek?

Kalinka Iaquinto

In most countries a shorter workweek is one of the main demands when labor law changes are being discussed. In Brazil, the 1988 Constitution cut the workweek from 48 to 44 hours to reduce unemployment. Although it is not a priority topic today, a shorter workweek is still often a union demand, and current proposals are to first reduce the workweek to 40 hours and then to 36, without cutting wages. The International Labor Organization says that most countries now have a 40-hour workweek.

According to José Pastore, professor in economics and business administration at the University of São Paulo, government data show that half of the workers in Brazil already work 40 hours or less weekly. "But this is being done by negotiation," he says, pointing out that setting the same workweek for different sectors may abruptly raise costs, which could reduce investments and jobs.

Alexandre Furlan, who chairs the Council of Labor Relations of the National Confederation of Industry, agrees that a shorter workweek discourages job creation. "You have a cost increase of at least 10% with no guarantee of growth in productivity," he says, adding that in the last 10 years industrial production grew only 4% while the minimum wage in U.S. dollars went up 100%.

"We should be working to reduce working hours without loss of pay, providing more time for leisure, education, and family. Unfortunately there is strong opposition from business, which says that costs will be increased. Nobody talks about lowering profit margins," says Artur Henrique da Silva Santos, assistant secretary of international relations of the Workers Central Union.

A study by Fernando de Holanda Barbosa Filho and Samuel de Abreu Pessôa, IBRE researchers, found that part of the loss of labor productivity between 1982 and 1992 was due to the reduced workweek. Unions disagree. "Today we manufacture twice as many products as in the past with half the number of workers on account of more advanced technology and increased productivity," says Silva Santos.

validity of collective bargaining: "The labor law is very restrictive of collective bargaining . . . it does not promote direct negotiations between labor unions and representatives of businesses."

FGV's Migliora believes that the best reform would be to allow free bargaining between workers and employers. "The labor legislation is not only expensive in terms of benefits, but also expensive in terms of management," he says.

Relatively simple company-labor agreements are not always respected by the courts. For instance, in some

companies, workers and employers agreed to reduce the time for lunch so that employees leave early or do not have to work on Saturdays, but the Labor Court has banned the practice.

Such court actions only bring losses for both parties. Companies lose because they risk prosecution, fines, and social charges, and workers lose because they are denied the working conditions they wish. "It's a huge waste of money, while the two parties could otherwise be in a win-win situation," Pastore says.

Although free bargaining between workers and employers is one of the few points where there is consensus between them, others disagree. Says Senator Paulo Paim (Workers' Party), "Who has more power in the negotiation, corporations or labor? Corporations. If employers say that they cannot meet some articles of the labor law, often employees will agree in order not to lose their jobs,"

Ives Gandra da Silva Martins Filho, Inspector General of the Superior Labor Court, believes that both legislators and judges are being paternalistic about workers, in many cases abolishing the role of unions. But he warns that not every category of workers is well-represented or has its interests protected. He also advocates reforming unions: "There is only a single union per category and they receive dues; today's union leaders do not want to change the system because they have easy money and a guaranteed monopoly. They do not negotiate in the best possible way and sometimes the worker is left unprotected and comes to the courts."

Labor law in Brazil is too subjective and does not actually protect those who really need protection.

Silva Santos of CUT admits that happens. He says some union representatives do not wish to change the status quo, and this insistence on relying on the state via union dues ultimately affects how these unions defend the interests of workers. "Some businesses call for more flexibility and changes in workers' rights under the law. We do not agree with this because first we need to have strong unions, truly representative. And that depends on changes in the structure of unions," he says. Some workers are asking that the government ratify Convention 87 of the International Labor Organization (ILO), which deals with freedom of association and protection of the right to organize. Silva Santos believes ratification of the ILO convention would reduce the number of worker suits against corporations.

Guarantee

The disagreements do not stop there. Congress is considering a very controversial topic: Law 4330 of 2004 governing outsourcing. No one disputes that the matter should be regulated; after all there is a worldwide trend to use contract labor. However, corporations need to have

Today, about 11 million Brazilians are contract workers, and most have no rights guaranteed as workers under the labor law have.

security about the extent to which they can outsource services, and contracted workers need to have some rights guaranteed.

Today, about 11 million Brazilians are contract workers, and most have no rights guaranteed as workers covered by the labor law have. A Dieese survey in 2011 found that contract workers work about three hours more a day, earn 27% less than permanent employees, and have less job stability. Moreover, 8 out of 10 workplace accidents in Brazil involve contract workers.

In Latin America, only Brazil and Colombia have no regulations on contractual labor. "Outsourcing is an irreversible phenomenon," says da Silva Martins Filho. "We need to outsource, but outsourcing should be done well and be as fair as possible."

Furlan agrees, explaining that "Outsourcing is a modern way to organize economic activities." With outsourcing, companies have access to more know-how, better techniques, and greater efficiency, which are linked to productivity.

A CNI survey highlighted that in 12 of the 27 manufacturing sectors, the share of companies that contract with workers is more than 60%; on average for industry, the share of contract workers in the total workforce of a company is 14%. Of companies that contract for services, 91% do so to lower costs, 46% think it makes them more competitive, 75% monitor to ensure that companies they contracts with comply with labor laws, and the majority also monitor whether the contractor complies with health and safety regulations.

Representatives of the workers do not see the picture in such rosy terms. They argue that discussions on regulating outsourcing should be broader to prevent fraudulent companies from operating in the market. "We need to build a proposal that ensures workers rights," says CUT's Silva Santos.

"It's hard to change the CLT because we have a Workers' Party government and unions see the labor law as something sacred," Migliora says, adding that Brazil will nevertheless eventually have to reform it not only to make the country more competitive but also to encourage entrepreneurship.

In Latin America, only Brazil and Colombia have no regulations on contractual labor.

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FGV IBRE

Brazil needs a better business environment



Luiz Fernando Furlan

Former Minister of Development, Industry and Foreign Trade

Solange Monteiro, São Paulo

IN THE 10 YEARS SINCE his service as a minister in the first term of former President Lula, Luiz Fernando Furlan believes that Brazil has recorded important achievements, but "We are prolific in diagnostics and announcements but meager in delivering results." Now a member of the boards of directors of such large companies as BRFoods (the merger of Perdigão and Sadia) and Vivo phone company and of the advisory boards for Panasonic (Japan) and Walmart (United States), Furlan says that investors still want to invest in Brazil, but the country needs to prioritize and make infrastructure concessions more attractive to keep Brazilian companies competitive.

***The Brazilian Economy*—Do Brazil's external trade balance deficit and the signs of a U.S. economic recovery indicate that the world may be losing interest in financing Brazil?**

Luiz Fernando Furlan—I do not buy that idea. Capital inflows to Brazil are behind only those to the United States and China, which suggests that the Brazilian market is still attractive. Consider companies like Fiat, the Italian carmaker—whose operation in Brazil is larger than in Italy—and Vivo telecommunications, for which Brazil is the most dynamic market . . . We are not as beautiful as we looked, but not so ugly as we are sometimes depicted. Many entrepreneurs I know still have plans to invest in Brazil because of our large domestic market. And with the devalued exchange rate, some are also considering exporting.

But the trade balance has fallen from a surplus of US$25 billion in 2003 to a deficit of US$5 billion so far this year. Have we lost an important source of funding for domestic consumption?

In 2003 there was no way to wake up the Brazilian economy except to export. Brazil could not make public investments, owed

the International Monetary Fund (IMF) . . . , interest rates were high, and the Brazil risk was above 1,000 basis points. The foreign market was virtually the only way out. And that's what we did: look for markets abroad, focusing on traditional products to new markets and new products to traditional markets. The Brazilian Agency for Export Promotion of Exports (Apex) worked diligently. The productive sector responded positively. And global economic growth was favorable. . . . Our share in world trade increased from less than 0.9% to something like 1.3%—a gain of 40% in market share. Foreign trade grew, trade balance surpluses turned into international reserves, and foreign debt declined—all in 10 years. I'm not pessimistic about either the current situation or Brazil's future.

But now there are demands, virtually unanimous, from society and businesses that need to be taken into account: better infrastructure, less red tape, punishment of corruption, better education and health services. And many of them, surprisingly, do not depend on resources, credit, or financing, because that is there. They depend on execution.

The public sector view of costs and benefits is not economic, it is political. So investments are often cut across the board to avoid complaints from governors of different states, and we end up with half a bridge, a third of a hospital, a piece of highway.

When you were appointed minister, it was already well-known that to be competitive Brazil had to invest in infrastructure. But there has still been little progress. Where have we failed?

I was minister when the government launched the Growth Acceleration Plan (PAC) in 2007. Again, the problem is government inability to carry out [large projects]. . . . São Paulo state, the richest in the country, may take over 20 years to complete the beltway, about 170 km of highway with no major technological challenges. And why take 20 years to improve traffic flow, which makes the population waste at least an hour of their day and generates more pollution and fuel consumption? . . . There is a lack of vision. In the private sector, if you have 10 projects scheduled and for some reason need to reduce your investment, you do not make cuts in all 10 across the board; you move forward with those that are more relevant and have a higher rate of return, and postpone the rest. Because the public sector view of costs and benefits is not economic, it is political, investments are often cut across the board to avoid complaints from

The solutions to the problems that plague Brazil today lie within the country.

governors of different states, and we end up with half a bridge, a third of a hospital, a piece of highway. … We are prolific in diagnostics and announcements and meager in delivering results.

I am an advocate of [environmental] sustainability, but also of rationality.

One of the main obstacles to major infrastructure projects in Brazil is environmental licensing. As chairman of the Sustainable Amazon Foundation, how do you see this situation?

Brazil has one of the more environmentally sustainable economies in the world. It has committed to reducing its CO_2 emissions by up to 39% by 2020 and unlike most other countries it can do that without major economic impact. That's because most of the emissions are related to setting fires, cutting trees, and deforestation to make pastures. These activities are being reduced with the collaboration of the private sector, as in the Amazon region, where slaughterhouses have pledged not to buy cattle from illegal areas, and the soy moratorium, which prevents planting in preservation areas. But we live with crazy overkill [regarding preserving the environment]. For example, near Congonhas airport, there is a parking lot. It took seven years to build because a group of neighborhood residents got an injunction against removal of 52 trees, even with the promise of planting trees after the work . . . I am an advocate of sustainability, but also of rationality.

When the public sector wants to arbitrate so many variables, investments become less attractive. A higher-risk investment should be awarded a higher rate of return.

Some say that one reason the economy is not recovering fast is the lower return on capital in Brazil as the government caps rates of return for concessions. Do you agree?

When the public sector arbitrates so many variables, investments become less attractive. A higher-risk investment should be awarded a higher rate of return. . . . Look at what happened with the tender for a high-speed train between Rio and São Paulo cities: it was suspended because only one company was interested. That is suggestive. We need to be aware of how much what we do not have is costing. Standing hours at the airport, for example, is expensive for both users and for the operating company. The main effect ultimately is a systemic loss of competitiveness for Brazilian companies.

Another example is the Port of Paranaguá in Santa Catarina state in southern Brazil. . . . One day I traveled to Santa Catarina, and when the plane passed over Paranaguá, there were more than 100 ships there. If you estimate the cost

of a stopped ship at about US$25,000 a day, that's throwing away US$2.5 million a day. Would US$2.5 million dollars a day pay for infrastructure improvement? . . . In the four months of the crop exporting season, the total loss is US$300 million. This money is paid by producers. … It is hard to explain why the cost of unloading a container is so much higher in Brazil than elsewhere. Peru has the most efficient port in South America. When we see that the infrastructure in other countries was built by Brazilian companies, clearly there is no lack of ability to execute [large projects].

Today, in Mercosur no member understands the others.

Must entrepreneurs operating in Brazil learn to cultivate patience?

On the contrary, it is necessary for them to be *impatient*. In the public sector, the most comfortable position is to say no, because that way you will never be sued. Therefore, it is important to reduce bureaucracy. When you create an automated system such as an electronic auction, you take away the power of people to be arbitrary and change the avenues of power. A few years ago in a friendly chat with then-Portuguese Prime Minister José Sócrates, I commented that Brazil suffered greatly from the Iberian heritage of notaries, stamps, notarization, and registration. He replied that Portugal had evolved: it had no official daily paper requirements, only electronic; and opening a company took only a few hours. In Brazil, we also tried to simplify company registry. The bill was stuck in Congress for several years, and was approved only after I left the government. Initiatives like this are important.

Are you optimistic about a trade agreement with the EU now?

At the first meeting of the World Trade Organization that I attended as a minister, the Japanese minister said Japan had no bilateral agreements. Ten years later, look at how many the Japanese have! They changed because others have changed. Chile, Colombia, and Peru also made trade agreements, but Mercosur has a rule that a member cannot make deals out of the bloc. Today, in Mercosur no member understands the others. Each passing day increases the list of exceptions to agreements signed by Mercosur countries. Should we stay tied to Mercosur?

What are the main global risks for our economic recovery by 2015?

The solutions to the problems that plague Brazil today lie within the country. If we can do our part, the external threat will be lessened greatly . . . If China demands less iron ore, how many people in Brazil are dependent on iron production? Not many . . . Will China demand less soy? It may. But there is an international market that regulates the price; Brazil is more productive than the U.S., and if Brazil solves its infrastructure problems, our commodity exports will be more competitive. . . . Also, improved productivity

would lower prices for consumers, which would also create additional demand.

As we approach the presidential elections we are troubled by inflation. What do you expect the government to do about it?

As Bill Clinton said in his first election: "It's the economy, stupid." Former President Fernando Henrique Cardoso used to say that when the price of the basket of basic staples rises, government approval plummets. We are now used to living with inflation stabilized at near 6%. How do you break this trend? A predominant source of inflation is the service sector, where productivity is less than in product markets . . . Will the economy be worse in 2014 than today? That is not very likely. Government approval bottomed out shortly after the demonstrations, and now the government is recovering some of its popularity. Moreover, the demonstrations attracted attention to the need to deliver results. Bringing in foreign doctors, although controversial, is a response to a popular demand. Public works will also accelerate. All this will happen during the presidential election campaign.

President Rousseff will have to convince voters that the four years of her first mandate were valuable in a context in which people's aspirations have changed, especially for those who had real income gains during this period.

I'm not pessimistic about the future, but Brazil must overcome certain dogmas. One, as I mentioned, is not being tied up by Mercosur. The other is that it's time to show results. Former President Lula was elected to a second term because of achievements in his first term . . . President Rousseff will have to convince voters that the four years of her first mandate were valuable, in a context in which people's aspirations have changed, especially for those who had real income gains during this period. ■



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The economic climate in Latin America and Brazil is worsening amid news of the slowdown in Chinese growth and its effects on commodity prices.

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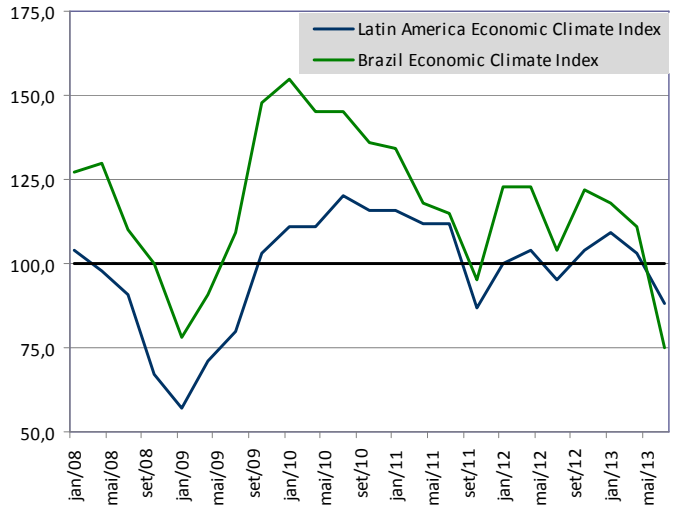
THE ECONOMIC CLIMATE INDICATOR FOR Latin America (ECI-AL) deteriorated in July and is below the historical average of the past 10 years. The deterioration in the indicator was due to both a less favorable assessment of the current situation and lowered expectations for coming months.

The deterioration in Brazil's economic climate reflects mainly unfavorable assessments of expectations since last April; the assessment of the current situation has been unfavorable since July 2012. Between April and July, the expectation index declined by 35%. Increasing inflation, an accumulation of trade deficits, and continuous downward revisions of the growth of the Brazilian economy in 2013 may have contributed to the deterioration in Brazil's economic climate.

In Latin America the economic climate has worsened in 7 of 11 countries surveyed. Only Colombia and Uruguay showed improvement. Expectations of a slowdown in Chinese growth and its effects on commodity prices have had a powerful impact in several Latin countries that heavily rely on commodity exports, such as Chile and Peru. So it is no surprise that the worsening economic climate in Asia, particularly in China, has been followed by similar behavior in Latin America.

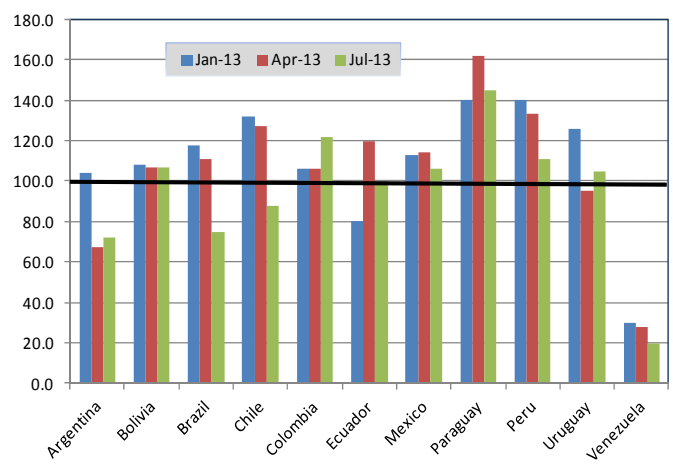
The Economic Climate Indicator is a quarterly survey conducted by the German Ifo Institute for Economic Research—the Ifo World Economic Survey (WES)—and the Brazilian Institute of Economics of the Getulio Vargas Foundation The ECI is an average of the assessment of the current situation and expectations 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.
http://portalibre.fgv.br/main.jsp?lumChannelId=402880811D8E34B9011D92BBCC431F08

The economic climate for both Latin America and Brazil deteriorated in July.



Source: Ifo World Economic Survey.

The economic climate worsened in 7 of 11 Latin American countries.



Source: Ifo World Economic Survey.

Recognizing that the Brazilian economy is still going through a challenging period, IBRE has marginally revised Brazil's growth outlook up to 2.5% in 2013 but is dropping it to 1.8% for 2014.

SECOND-QUARTER GDP SURPRISED on the upside: It grew a brisk 1.5% quarter-on-quarter (q-o-q) compared to 0.6% q-o-q in the first quarter. GDP growth was 3.3% compared with growth in the same period of last year, 1.0 percentage point higher than our projection and 0.6 percentage points above market expectations.

However, despite the euphoria that followed the release of second-quarter GDP, nothing fundamental has changed. There are still no definitive signs of a more lasting recovery. The IBRE Indicator of Economic Activity, which approximates the moving average for quarterly GDP, fell by 1.2% in July.

We hold to our scenario of a slowdown in growth in the second half of the year. The reasons are various: We expect a downturn for industry and agriculture, whose growth in the first two quarters of the year was exceptionally high. Domestic demand should also slow because investment is cooling and is projected to decline by 1.0% q-o-q. This expectation is supported by the IBRE confidence surveys, which are still low in historical terms and suggest that the economy will slow in the third quarter. In particular, the surveys suggest that gross investments will fall back in the third quarter of 2013, putting at risk the recovery of not just investment but also growth.

We forecast that GDP will fall by 0.4% q-o-q in the third quarter. For the year, our expectation is for 2.5% growth, up from the 2.3% we previously forecast because we expect some recovery in the fourth quarter. Despite the presidential elections next year, we consider it more realistic to reduce our forecast for GDP growth to 1.8% for 2014 rather than the 2.6% of our previous forecast.

Undoubtedly, Brazil is undergoing a process of growth deceleration and exchange rate devaluation, reflecting a more adverse international scenario. The exchange rate has been devalued substantially in recent months, which has helped to push up inflation and is also making it more necessary to adjust domestic fuel prices, which so far the government has been reluctant to do. To curb inflation, the current expansionary fiscal policy will require higher interest rates, which will penalize economic growth in 2014.

Brazil: IBRE baseline scenario, 2010-2014

	2010	2011	2012	2013 June Proj.	2013 Sep. Proj.	2014 June Proj.	2014 Sep. Proj.
Real GDP growth (% change)	7.5	2.7	0.9	2.3	2.5	2.6	1.8
Inflation (% change)	5.9	6.5	5.6	6.1	5.9	5.8	5.9
Central Bank policy rate (end-period, %)	10.75	11.00	7.25	8.75	10.00	8.75	10.00
Exchange rate (average, Reais per U.S. dollar)	1.8	1.7	1.9	2.1	2.2	2.1	2.4
Budget primary surplus (% of GDP)[1]	1.2	2.5	1.7	1.4	1.0	1.2	0.4
External current account balance (% of GDP)	-2.3	-2.1	-2.2	-3.2	-3.5	-3.4	-3.3
Trade balance (US$ billions)	20	30	18	7	2	9	8
Export (US$ billions)	202	256	243	243	241	254	242
International reserves (US$ billion)	289	352	378	390	380	390	390

Source: Brazilian Institute of Geography and Statistics, Central Bank of Brazil, IBRE staff projections.
[1] Excludes interest payments on public debt, and revenues from dividends and concessions.