THE BRAZILIAN ECONOMY

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IBRE Economic Outlook
Brazil's economy is on hold, and policy changes are unlikely before the 2014 election

IBRE Seminar
How to accelerate infrastructure projects

Foreign Policy
The Brazil-US benign neglect myth



CAN BRAZIL GET ITS CITIES MOVING?

Traffic jams are strangling Brazil's large cities and causing billions of dollars in losses, requiring substantive changes in urban planning

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The BRAZILIAN ECONOMY

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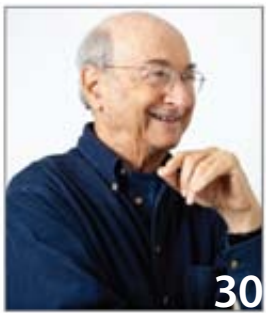
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When President Dilma Rousseff decided to postpone her state visit to the United States in October, there were immediate ramifications. João Augusto de Castro Neves explains how risks to US companies operating in sensitive sectors like IT and defense will have a harder time selling to Brazil. In the energy sector, major American oil companies decided to skip the first deep sea oil bid round. In sum, he says, both countries stand to lose from the episode.

Cover Story

10 Can Brazil get its cities moving?

Getting to work is a nightmare for urban dwellers, wasting time and costing millions in financial and productivity losses. Talking with the experts behind several recent studies, Solange Monteiro explains how the problem is not just too many cars and poor public transportation but also failure to plan for appropriate densities of residences and businesses. She also describes what has worked elsewhere to keep people mobile. Mauricio Pinheiro Canêdo comments on where the economic burden should fall.

Infrastructure

20 How to accelerate infrastructure projects

How to unlock construction projects was the theme of the 3rd IBRE Seminar of Infrastructure: Bottlenecks and Solutions in Brazilian Transport Infrastructure in early September. Excessive regulation and falling rates of return to the private sector are among the major problems participants identified. Solange Monteiro reports.

Economic Policy

24 Politics, the global outlook, and economic adjustment

Good external and domestic news has increased the chances that Brazil will not undergo a dramatic adjustment of the external balance before the presidential elections in 2014, says Fernando Dantas. But he also sees reasons for concern in such areas as Brazil's growth potential and some policies that are likely to be unsustainable.

Interview

30 Cities in transition

Twice Planning Secretary of São Paulo city, Jorge Wilheim has also drawn up urban plans for several other Brazilian cities. In an interview with Solange Monteiro, he criticizes misguided policies that have prevented expansion of public transport in Brazil, commenting that "The abandonment of the railroad in Brazil was a clear mistake." He also has strong opinions on such areas as inter-municipal planning and even on what Brazil has done right in the past.

IBRE Economic Outlook

35 Brazil's economy is on hold, and policy changes are unlikely before the election. Declining confidence points to a fall in GDP growth in the third quarter; IBRE holds to its forecast of a 0.4% contraction in third-quarter GDP and 2.5% growth for 2013.

ECONOMY

Third consecutive fall in industrial employment

The labor force in industry fell 0.2% in July compared to June, and 0.8% compared to June in 2012, said the government statistics agency IBGE. In the first seven months of 2013, total employment in industry declined by 0.8% compared with the same period a year earlier. (September 11)

Industry plans to invest less

In August the share of Brazilian companies planning to invest more in the next 12 months reached its lowest level in a year, the Getulio Vargas Foundation's Industry Investment Survey found. Only 34% of companies surveyed planned to invest more, down significantly from 51% in May. Those who expected to invest less rose from 15% to 17%. (September 12)

Retail sales surged in July

Seasonally adjusted retail sales exceeded expectations by growing 1.9% in July, pushing the year-on-year figure from 1.7% in June to 6 percent. Sales were the highest since January 2012, when they hit 2.8%. (September 12)

Economic activity drops in July

The central bank's economic activity index declined a seasonally adjusted 0.33% in July from June, the bank said on Friday. Economic activity contracted less than expected as retail sales offset some of the steep decline in manufacturing. (September 13)

Unemployment down to 5.3%

Unemployment stood at 5.3% in August, down from 6% in June, according to IBGE. However, the decline is partly due to a reduction in the economically active population. Although employment grew, the labor market is no longer as vigorous as a year ago. In the second half of last year, employment grew between 2.5% and 3% year-on-year, while employment grew 0.9% from July to August 2013. Per capita income, estimated at US$862, reversed the previous month's downward trend to rise to 1.7% in August. Compared to August 2012, incomes grew by 1.3%. (September 26)

Stock exchange up in September

The Ibovespa index ended September at 52,338 points, up 4.6% from August. Market capitalization of the 364 companies listed on the BM&FBOVESPA in September was R$2.40 trillion, compared to R$2.30 trillion in August. (October 3)

Consumer prices rise

The rise in the official consumer price index for September was 0.35%, and 5.86% for the 12 months through September, as food inflation eased after a steep increase in late 2012, IBGE reported. (October 9)

POLITICS

Silva and Campos join forces

Unable to register a new party to support her run for president, former Senator Marina Silva has joined up with the PSB (Brazilian Socialist Party),which already has a presidential candidate, Pernambuco Governor Eduardo Campos. Silva appears willing to run for vice president on the Campos ticket. Considering that Silva got 19.6 million votes (19%) in the 2010 election and is currently second in the polls, the alliance gives the Campos candidacy considerable muscle. The alliance increases the likelihood of a run-off in the election; polarization is likely to be fierce. (October 5)



Photo: João Cruz/ABr.

Former Senator Marina Silva and Pernambuco governor Eduardo Campos

PSB leaves President Rousseff's cabinet

Political party PSB resigned from the two cabinet posts it held—National Integration Ministry and the Ports Secretary—though it is still likely to vote with the governing coalition. The move gives PSB head Eduardo

Campos more independence to run for president. (September 17)

President Rousseff's popularity is returning

September polls showed restoration of some of President Rousseff's popularity, and as for intention to vote, no other candidate was able to capitalize on the June protests. Rousseff (PT) rose from 30% to 38% in voter preference for the 2014 presidential race, Marina Silva dropped from 22% to 16%, Senator Aécio Neves (PSDB) from 13% to 11% and Pernambuco Governor Campos (PSB) from 5% to 4%. (September 26)

Senator Neves advocates for private investment

During a lecture to businesspeople in São Paulo, Senator Aécio Neves (PSDB), a likely candidate for president in 2014, said that an efficient government, meritocracy, and private investment are critical for Brazil's economic development, explaining that "we will be ready to resume growth when the public sector understands that the private sector is not an enemy to be fought; it is an essential partner to leverage investments." He also advocated reducing Brazil's 39 ministries by half. (September 30)

INTERNATIONAL

President Rousseff reacts to NSA spying

At the UN general assembly President Dilma Rousseff accused the US National Security Agency (NSA) of violating international law by its indiscriminate collection of personal information on Brazilian citizens and economic espionage targeted at Brazil's strategic industries. Because of the NSA incident, President Rousseff had earlier canceled what would have been the first state visit of a Brazilian president to the U.S. in nearly two decades. Despite many shared values, mutual distrust continues to hinder deeper engagement between the two countries. (September 24)



Photo: Roberto Suckert Filho/PR

President Dilma Rousseff at the opening of the 68th United Nations assembly

ECONOMIC POLICY

Oil royalties to be reserved for education, healthcare

President Rousseff signed into law a bill that earmarks all royalties from the country's huge off-shore reserves for spending on public education and healthcare. The law calls for 75 percent of royalties from deep sea oil to be spent on public education and 25 percent on healthcare. (September 10)

Federal revenues grew in August

Federal revenues totaled R$84 billion in August, up 2.7% compared to the same month last year, adjusted for inflation; revenues for the year reached R$722 billion, an increase above inflation of only 0.79% over the same period of 2012. However, the government sacrificed R$51 billion in taxes due to tax exemption programs—almost 72% more than in the same period last year. (September 23)

Central Bank policy rate hits 9.5%

As expected, the Brazilian central bank has raised the policy interest rate by 50 bps to 9.5%. The Monetary Policy Committee vote was unanimous. The central bank seems determined to continue monetary tightening. (October 9)

JUDICIARY

Supreme Court accepts appeals of convicted former officials

By 6 votes to 5, the justices agreed to hear the appeals of former officials of President Lula (2003–10) who were convicted of corruption in October 2012. Of the 25 convicted, 12 will have their sentences re-evaluated, opening the possibility that former Minister José Dirceu, former PT treasurer Delúbio Soares, and former mayor João Paulo Cunha will avoid prison. (September 18)

FGV Brazil

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Who would want to partner with the government?

AFTER BRAZIL'S RAILWAYS WERE privatized in 1996-1999, freight transportation increased by 117% between 1997 and 2011; the federal government not only eliminated a source of public deficit it also raised R$15 billion in taxes and concessions; and the private sector invested almost R$30 billion.

This year when the federal government tried to auction off the BR 262 road concession, which it considered an excellent investment opportunity, not one firm showed up. It was a total lose-lose proposition. Why the lack of enthusiasm?

For one thing, no one —last of all savvy business people—wants an unwilling partner. It's clear that the president and her administration have opted for concessions more out of necessity than conviction. The government is not really conceding control; it's giving revenue guarantees and low-interest National Development Bank loans and even planning to do part of the construction—something it has proved unable to do on its own, which is why it turned to concession arrangements again in the first place. In some concessions, government agencies like the Brazilian Airport Agency actually have rights to veto a partner's plans.

In other words, federal government hands are everywhere in the way these concessions are structured, and there are plenty of other hands as well. As one participant in the recent IBRE seminar on infrastructure pointed out, there are conflicts of jurisdiction between the federal government and the states, and regulations that allow all sorts of agencies to intervene at will in projects.

Rates of return to private partners on infrastructure projects are also a major issue. Between 1994 and 2000 rates of return on road concessions were 18%-20%; in the 1997 auction return had plunged to 9%. And now there's the possibility that the government will cap private sector road profits by restricting tolls.

There are other reasons for the private sector skepticism regarding government's concessions. For one thing, it keeps changing the rules of the game. So why would private investors expect that the rules governing concessions today will still be in place 30 years from now? The ones governing energy concessions didn't last out their terms.

The government keeps changing the rules of the game. So why would private investors expect that the rules governing concessions today will still be in place 30 years from now?

In talking about the problems of ports, one seminar participants said, "We live in a scenario of low investment and institutional mess." The comment applies no matter what the mode of transportation. It's estimated that Brazil has an infrastructure gap of US$1 billion. Where will the money come from? And if it were somehow found, how would projects get done any faster when there's no one-stop shop for getting all aspects of a project approved? Private investment depends on at least some degree of certainty. It's estimated that institutional and regulatory risk in Brazil reduces returns by 2.0 – 2.7 percentage points.

No wonder private investors are reluctant to partner with the government.

The Brazil-US benign neglect myth

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

WEEKS OF SPECULATION came to an end when President Dilma Rousseff decided to postpone her state visit to the United States in October due to allegations that the US National Security Agency has been intercepting government communications. The decision definitely struck a nerve, especially because it would have been the first state visit of a Brazilian head of state to the US in nearly two decades.

The goal of the trip was to find something that would catapult bilateral engagement to a new level, perhaps a roadmap for a trade agreement or talks on UN Security Council reform. Now policy makers in Brasilia and Washington are working to prevent the relationship from deteriorating even further.

For starters, the risks to US companies operating in sensitive sectors with political and even operational constraints have increased considerably. This is chiefly the case in defense, telecom/IT, and energy sectors. Cooperation in defense will most likely be affected, with Boeing's chances of securing a contract to sell fighter jets to the Brazilian Air Force now significantly reduced. The caveat is that a decision on the bidding process is not imminent, given the fiscal constraints the Brazilian government is currently facing. That is why, instead of openly disqualifying Boeing, Rousseff opted to delay the entire process.

In the energy sector, major American oil companies decided to skip the first deep sea oil bid round, in part to avoid what would probably be a political firestorm if they won. After all, Petrobras was one of the targets of NSA eavesdropping (although the real reason here may have had more to do with certain aspects of the way the oil sector is regulated than with the NSA episode).

Finally, telecoms/IT is the sector most likely to feel the impact of the NSA scandal. Spying revelations reinvigorated the government's push to approve regulations for the Internet in Brazil and to require Internet companies to house Brazilian user data within the country, which would raise costs for companies even though it would not prevent them from also housing copies of the data abroad. Such a policy would serve two purposes: It would give the government a political victory and it would also allow the government and courts to subpoena Brazilian user data.

But while expectations of more positive developments between Brazil and the

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While expectations of more positive developments between Brazil and the US will certainly shift to the negative, the good news is that the uptick in nationalist sentiment in Brasilia is unlikely to escalate into a full-blown trade war.

US will certainly shift to the negative, the good news is that the uptick in nationalist sentiment in Brasilia is unlikely to escalate into a full-blown trade war. In the near term, no new major policy overtures are expected. Furthermore, increased tensions will not be enough to disrupt most current negotiations on the bilateral business agenda, such as efforts to streamline visa issuance and to enhance cooperation on taxation issues. Negotiations on most of these topics tend to progress at a technocratic level, independent of presidential diplomacy.

More importantly, intertwined interests between American companies operating in Brazil and Brazilian companies operating in the US are likely to continue to set the tone for talks on most issues on the economic and commercial agenda once the dust of the incident settles—and barring any new NSA revelations.

Until then, both countries stand to lose from the episode. For the Obama administration, closer rapport with Brazil could have added a fresh and more positive item into a troubled foreign policy repertoire. For Brasília, deeper engagement with the US would give the Rousseff government an opportunity to enhance an otherwise unimpressive diplomatic record. For a country that aspires to climb the ladder of global power, recognition and even support from the world's enduring "lone superpower" is crucial.

For the last two decades or so, Brazil-US relations have been markedly bumpy. Differences with respect to the Colombian drug problem, Brazil's nuclear and space programs, hemispheric free trade negotiations, Chavez's Venezuela, Honduras's *coup de état*, and Iran's nuclear program, among others, have resulted not in a policy of benign neglect but in what some have called a paradoxical disconnect between the two largest economies and democracies in the hemisphere. In the end, despite many shared values, mutual distrust continues to hamper deeper engagement.

The NSA eavesdropping scandal is blatant proof of that mistrust on the US side. The question now is whether the information collected over the years confirms much of its suspicion of Brazil.

Despite many shared values, mutual distrust continues to hamper deeper engagement.

CAN BRAZIL GET ITS CITIES MOVING?



Traffic jams are strangling Brazil's large cities and causing billions of dollars in losses, requiring substantive changes in urban planning.

Solange Monteiro, *Rio de Janeiro*

TRAFFIC CHOKES UP OVER 200 KILOMETERS (124 miles) of major thoroughfares in rush hours in São Paulo city. It is a nightmare that every resident of a major Brazilian city must deal with to get to work: wasted time, exposure to pollution, and deterioration in the quality of life. The lack of urban planning and investment in public transport, combined with a policy of encouraging use of the automobile, is not unique, but São Paulo city leads other major Brazilian cities in immobility, wasting residents' potential as well as their time.

Traffic jams also cause financial and productivity losses, which aggravates social inequality in large cities. A study by Marcos Cintra, vice president, Getulio Vargas Foundation (FGV), found that the opportunity cost of time lost by people in traffic jams and the financial cost of additional spending on fuel, goods transport, and pollution controls reached US$20 billion in São Paulo city in 2012.

In Rio de Janeiro city, traffic congestion now obstructs over 130 km (81 miles) and in 2012 represented a loss of US$14 billion, according to a survey by the Federation of Industries of the State of

Rio de Janeiro (Firjan). Another study, this one by the Institute of Economics of the Federal University of Rio de Janeiro (UFRJ), calculated that the time residents waste in traffic already represents a loss of 5% of the region's GDP. "If we valorize this time conservatively at 50% of average hourly earnings, the losses total US$3 billion," says Carlos Eduardo Frickmann Young, the economist who coordinated the UFRJ survey. This is the same amount the municipality has estimated would cover the construction of 150 km of BRT (bus rapid transit) and 30 km of LRT (light rail transit) projects for the Municipal Olympic Company to improve transport in Rio by 2016.

The UFRJ study also demonstrated that the wasted time is more harmful to those whose incomes are lower. "We recorded greater losses where the human development index (HDI)[1] is lower, and among people who most need time to study and acquire skills," Young says. "If someone looks for work downtown in search of better pay, the person loses time to study; if someone accepts employment where she lives, she is not able to increase her income," he explains.

São Paulo city leads other major Brazilian cities in immobility, wasting residents' potential as well as their time.

Street demonstrations last June, triggered by the rising price of bus fares and the low quality of public transport, illustrated the population's dissatisfaction and have prompted governments to invest more on transportation. For specialists, however, consistent change for the better in urban mobility will depend on the resumption of long-term urban planning and society's willingness to deny the culture of automobile hegemony, taxing the use of cars to subsidize public transport.

Photo: Cidadeolimpica.com



Rio de Janeiro: Alvorada Terminal Bus Station receives passengers from both TransOeste and TransCarioca BRTs.

THE SHAPE OF CITIES

Urban planners are unanimous in pointing out that the problem is not simply slow buses or the absence of metro rail but the disorderly expansion of cities. The density of São Paulo city, for example, at 100 inhabitants per square km (260 inhabitants per square mile) is half that of cities like New York or Tokyo,

Traffic jams also cause financial and productivity losses, which aggravates social inequality in large cities.

whose planning allowed for more people without the same drawbacks. In São Paulo, about two million people move every day from the east zone to work in the center, where there is a concentration of 153 jobs per city resident. "Without bringing economic development to the east zone and encouraging more people to live downtown, investing in transportation will be futile," says architect and urban planner Carlos Leite.

To improve this situation, recently São Paulo Mayor Fernando Haddad sent to the City Council a proposed revision of the city master plan that includes exemption from property tax in the east zone to attract service companies, especially call centers, information technology, hotels, and education.

In Rio de Janeiro, in addition to four BRT lines and the LRT and expansion of metro rail, consolidation of the city master plan to cover the entire metropolitan region is also being studied, with financial support from the World Bank. Consisting of 19 municipalities that account for 70% of the state population, the metropolitan area is highly dependent on Rio city, which has 75% of the jobs. However, a number of major projects should stimulate economic activity in the east zone, notably the Petrochemical Complex of Rio de Janeiro (Comperj), now under construction in Itaboraí, and in the municipality of Itaguai a major base to support deep sea oil operations offshore. The increase in oil production activity could promote decentralization of labor opportunities, with creation of about 800,000 jobs outside Rio city in 15 years, according to state government estimates.

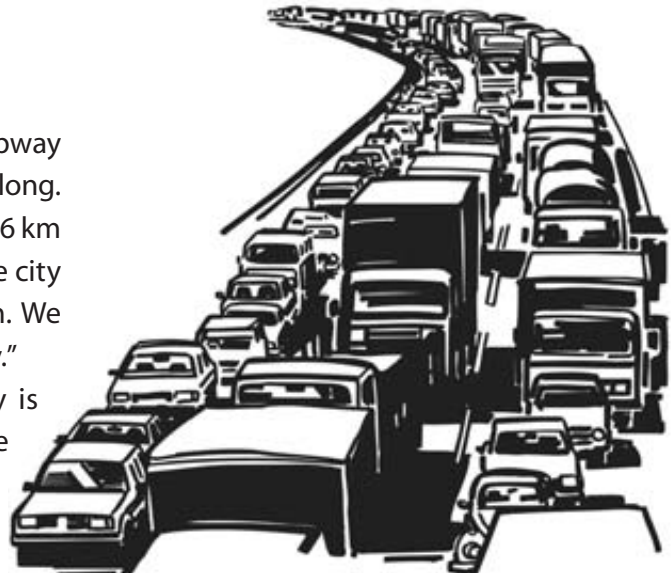
IT'S NOT ABOUT HIGHER BUS FARES

Together with the lack of urban planning, the option for individual transport worsens mobility in large cities. "This feature is part of the evolution of Brazilian society," explains Samuel Pessôa, head of the Center for Economic Development of the Brazilian



Photo: Tânia Rêgo/ABrFoto: Tânia Rêgo/ABr.

The poor quality of public transport in major cities such as Rio de Janeiro drew protests recently.



Institute of Economics (IBRE). "The subway in São Paulo is 45 years old and is 74 km long. This means it has expanded at about 1.6 km a year . . . at that rate, it would take the city 200 years to expand metro to 400 km. We no longer have the time or the money."

Today, Pessôa points out, society is tired of endless traffic jams, and the political balance has changed since the street demonstrations last June, which were triggered by a rise in bus fares despite the bad quality of public transport. As a result, the government has pledged an additional US$23 billion in investments in urban mobility. "It is clear that the decision is not a technical issue—society's demands have changed the situation," agrees Otávio Cunha, CEO of the National Association of Urban Transport (NTU). "Clearly you do not solve an issue of this magnitude overnight. We transport 40 million passengers daily in cities that have grown in a disorderly way," he says. "But we are already seeing positive responses.

Ironically, the reality shock is pushing municipal governments to revert to a system that was actually created in Brazil 40 years ago: the BRT. The system of dedicated lanes for large buses launched in 1970 in Curitiba city has now spread worldwide, but until now it had not been welcomed in most of Brazil. The system has high capacity—40,000 passengers an hour in each direction—thanks to buses operating for a significant part of their journey within a fully dedicated right of way, which avoids tying up other traffic. "Currently, 54 BRT projects are being carried out in 19 cities in Brazil," Cunha says.

Of the 2,908km (1,807 miles) of urban roads funded since 2007 by the federal government, 567km (352 miles) are BRTs. "In São Paulo city, which has many narrow streets, putting in place the BRT requires costly land expropriation, which delays the work and becomes an additional difficulty as the city already has considerable debt," says Ciro Biderman, chief of staff, SPTrans. The goal of São Paulo is to have in place by 2016 the same extent of BRTs as Rio, 150km. In Rio, expectations for BRTs are

Consistent change for the better in urban mobility will depend on the resumption of long-term urban planning and society's willingness to deny the culture of automobile hegemony, taxing the use of cars to subsidize public transport.

"Clearly you do not solve an issue of this magnitude overnight. We transport 40 million passengers daily in cities that have grown in a disorderly way."

Otávio Cunha

also high. "Between 2003 and 2011, the fleet of city vehicles grew 34%, and traffic increased by more than 51%," says engineer Fernando Mac Dowell, former director of Metro Rio.

LOW FARES AND EFFICIENCY

Faster BRTs and dedicated bus lanes can reduce operating costs by 20%, according to NTU's Cunha. "This reduction occurs when commercial vehicle speeds increase by 50%. In São Paulo, buses that used to operate at 14km an hour have already increased to 20km on some lines, and BRTs can now reach up to 35km," he says. Improving the system by reducing operating costs and achieving affordability, however, will depend, according to experts, on whether society is willing to change the cultural precedence of individual transport, which has rendered public transport more expensive in the last decade.

The cost disparity between individual and collective transport is a result not only of the tax subsidy and ample credit for purchasing cars. A survey by the Institute of Applied Economic Research (IPEA) found that between January 2000 and December 2012 the price of gasoline rose 122%, slightly below the National Index of Consumer Prices of period (125%), but bus fares increased 192%. "The bus suffered greatly from higher operating costs and fewer passengers," says economist Carlos Henrique Ribeiro de Carvalho, co-author of the IPEA study.

Operating costs of buses rose mainly because diesel prices shot up. "15 years ago diesel represented 8% of the fare; today it is about 25%," Carvalho says. To make matters worse, demand for bus transportation in the same period dropped by about 25% because services deteriorated due to a lack of investment —which further stimulated the switch to



Foto: Filipe Matos Frazão Shutterstock.com

São Paulo city has adopted a rotation system where private vehicles can circulate only on certain days of the week to alleviate traffic jams.

individual transport. "This increase in cars, in turn, affected traffic, so that it took more buses to ensure the same frequency of services, creating even more pressure on costs," says Carvalho.

WHO PAYS THE BILL?

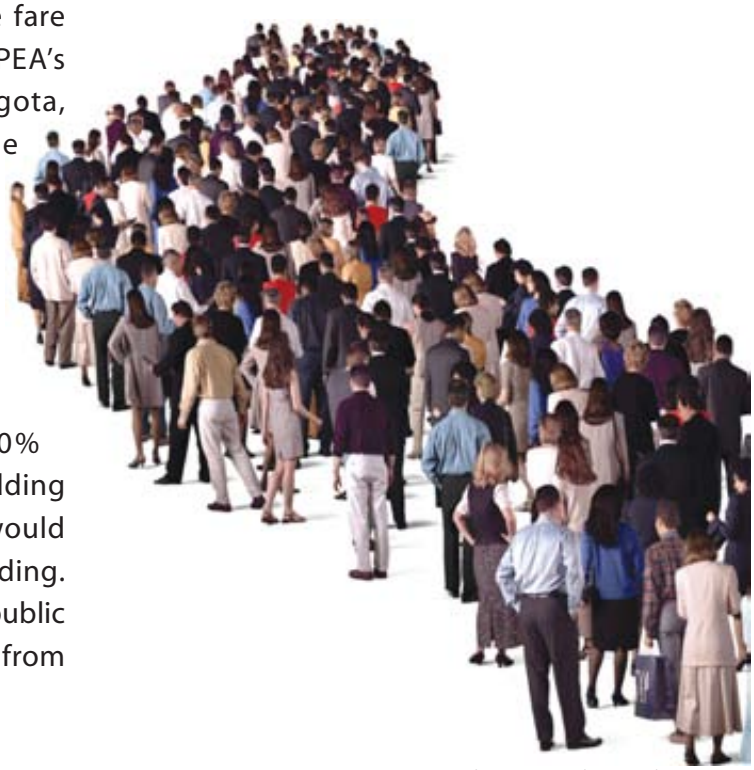
In this context, the person most affected is the user of public transport. The transport share of household income averages 3.4%, but it reaches 13.6% for the poorest households in the nine largest metropolitan areas, according to a 2009 survey. There have been some efforts to reduce operating costs: a cut in payroll taxes since January represents a cost reduction of about 4%, and a cut in social contributions last June reduced costs by 3.65%. Experts argue, however, that the low tariffs should also be based on a model of subsidy to public transport that covers all of society, including car users. Subsidizing public transport is common in European countries, where about 50% of the fare is paid for by exclusive funding. IPEA's Carvalho cites the example of Bogota, which taxes gasoline to finance the Trans Milenio BRT, and notes that "In Asian countries like Singapore, you pay a high fee for licensing cars, the revenue from which goes to finance public transport."

NTU's Cunha estimates that subsidizing urban bus rides by 50% would cost about US$23 billion, adding "It's a significant amount, which would require a permanent source of funding. Today only São Paulo city subsidizes public transport, with about 20% coming from the municipal budget." IPEA's Carvalho notes that this harms the poorest twice: first because taxation is indirect and ends up hitting the low-income population harder, and second, taking money from the budget compromises other social spending, such as on education and health, adding "That is why it is important to discuss new sources of funding for urban transport."

"The system needs to be rationalized so that when you create the subsidy it does not underwrite existing inefficiencies."

Otávio Cunha

One alternative revenue source is property taxes on the use of urban space,



"Subsidizing diesel for public transport, which is equivalent to less than 2% of total consumption in the country, we could reduce bus fares by 20 % in Brazil."

Carlos Henrique Ribeiro de Carvalho

as for parking, and even urban tolls, which although controversial are charged in some countries. "We also cannot rule out the productive sector, which already pays for some public transportation vouchers for low-income employees," Cunha says. Advocates of subsidies for public transport want to restore the Contribution for Intervention in the Economic Domain (CIDE) in gasoline. The history of this tax sheds light on the policy that has benefited individual transport for the last decade: When it was created in 2001, the CIDE tax on gasoline was R$0.50 and in 2002 it went up to R$0.86. Starting in 2004 it declined until it was eliminated in June 2012 to avoid passing on higher prices to consumers.

The return of a CIDE tax would be a win-win strategy: there would be no budgetary impact, and it would not be inflationary. "It would raise the price of gasoline, but lower the cost of diesel, which has a positive impact on bus fares and consequently on inflation," Carvalho says. He thinks a rate of R$0.22 would be sufficient to eliminate the fuel cost impact on bus fares. "By subsidizing diesel for public transport, which is equivalent to less than 2% of total consumption in the country, we could reduce bus fares by 20% in Brazil," he says.

An FGV Projects study, coordinated by economist Samuel Pessôa, corroborates the effects IPEA has identified. Pessôa says that a tax of R$0.10 per liter of gasoline would make it possible to reduce bus fares by 14% and the consumer price index by 0.22%. A study last year by the National Agency of Public Transport (ANTP) pointed out that in 2011 there were 12.5 billion bus rides in cities with over 60,000 inhabitants and sales of 35.5 billion gallons of gasoline. Using these numbers, Pessôa estimates that charging R$0.10 per liter would allow for a subsidy of about R$0.28 per ride.

An area that should be dealt with before subsidizing public transport, Cunha believes, is how urban transport is organized: "The system needs to be rationalized so that when you create the subsidy it does not underwrite existing inefficiencies. . . . We have a unique opportunity to change urban mobility in Brazil, and we should not waste it."

1 The HDI is a composite statistic of life expectancy, education, and income indices used to rank countries into four tiers of human development.

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Untying the knot of urban mobility

Mauricio Pinheiro Canêdo

Researcher and economist, IBRE

THE PROBLEM OF URBAN MOBILITY was behind the demonstrations that recently rocked Brazil, which were triggered by a rise in bus fares. A positive outcome of the protests was to bring this issue to the center of the political agenda. The question now, of course, is what to do. The solution will necessarily involve some form of subsidy to public transport.

From an economic standpoint, with subsidies and taxation individual actions have effects on other people. This is precisely the case of urban mobility. When making the decision to use private transport to get around, people do not take into account the negative effect generated for other people in terms of pollution and traffic jams. For this reason, as a result of the sum of all individual decisions, we end up with more cars on the streets than are needed, or appropriate.

The solution to this problem is to make public transport relatively cheaper than private cars. This

may involve either subsidizing public transportation or taxing private transport, as occurs in most cities elsewhere in the world. However, this has not been the practice in Brazil, particularly for bus transport. With rare exceptions, the system is fully funded by collecting fares.

The result is that in Brazil public transport fares have risen far above inflation, which has led people to abandon official transport systems. The wealthiest use individual cars and motorcycles; the poorest use illegal public transport. The result is more pollution, more traffic jams, higher costs and fewer people to pay fares to fund public transport. This brings about more increases in fares, feeding the vicious circle. This vicious circle has been exacerbated by recent government incentives for private transport by reducing taxes on vehicles and controlling fuel prices.

If the solution of the problem of urban mobility involves subsidizing public transport, who will pay the bill? The most obvious targets are taxpayers and users of vehicles.

Use of the budget has the disadvantage that, when tax revenues stay the same, resources are drawn from other areas. This tension became clear during the demonstrations, when many mayors indicated that if they could not raise bus fares, they would use resources from other areas to subsidize them.

Sending the bill to those who benefit from individual transport has the advantage of burdening only those that cause pollution and traffic jams. However, even this choice is not trivial. Taxing gas and using the revenues to subsidize public transportation, as suggested by the mayor of São Paulo city, has the disadvantage of reaching indiscriminately both those who drive in congested areas and those who use their cars outside those areas.

There is no single perfect policy to untie the knot of urban mobility—every town needs to find its own policy.

This problem can be circumvented by adoption of a toll, as in London, which has considerably reduced use of cars in the city center. However, in Brazil there is already considerably resistance to paying tolls on the open road; imagine collecting them in cities. More politically feasible would be to raise funds by charging for parking areas. But this option may not generate sufficient resources to subsidize public transport.

There is no single perfect policy to untie the knot of urban mobility—every town needs to find its own policy. Whatever the policy, there should be no room for populism: subsidies to public transport are justifiable and necessary, but we need to define clearly the most appropriate source of funding, and generate political will to collect the resources from those who must pay for the subsidy. Just as there is no free lunch, there is also no free bus fare.

How to accelerate infrastructure projects

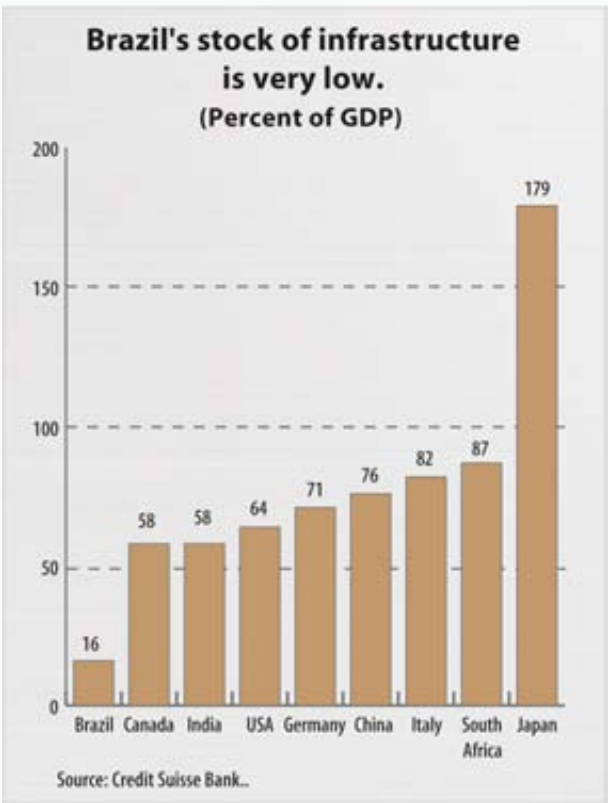
Experts discuss how to speed up completion of logistics and infrastructure projects in Brazil.

Solange Monteiro , *Rio de Janeiro*

ALTHOUGH BRAZILIAN INFRASTRUCTURE has captured attention in recent years, with several regulatory revisions and policies to stimulate investment, the country still faces serious difficulties in turning around its precarious infrastructure. How to unlock and accelerate construction projects was the theme of the 3rd IBRE Seminar of Infrastructure: Bottlenecks and Solutions in Brazilian Transport Infrastructure in September.

Luiz Guilherme Schymura, IBRE director, illustrated the current situation with a study by Credit Suisse bank, which found that the average stock of capital in infrastructure in the most dynamic countries is 70% of GDP. "In Brazil," he said, "the stock of infrastructure is only 16% of GDP. To reach 70%, Brazil would have to eliminate a gap of US$1 trillion in investments."

Several experts presented detailed studies of transportation modes and analysis of regulatory, environmental, and financing issues (which will be collected in a book). In general, Schymura evaluated how the difficulties the public sector has in carrying out projects affects what the private sector does, mainly because of the unpredictability of macroeconomic rules and excessive bureaucracy and deficient coordination among government agencies



that must approve projects. For example, Ronaldo Seroa da Motta, lecturer at the University of the State of Rio de Janeiro (UERJ), pointed out that "We have conflicts of jurisdiction between the federal government and the states, and sector regulations that allow many institutions, as well as the Attorney General, to interfere at any stage of licensing process." Da Motta emphasized that these conflicts lead interested parties to seek individual negotiations and insure against possible damage, which makes project costs uncertain—and usually higher than initially foreseen.

"We have conflicts of jurisdiction between the federal government and the states, and sector regulations that allow many institutions, as well as the Attorney General, to interfere at any stage of licensing process."

Ronaldo Seroa da Motta

The regulatory problem was also underlined by other experts. "When regulatory quality improves, investors are willing to pay more for the same amount of profit," noted João Manoel Pinho de Mello, economist, Catholic University of Rio de Janeiro (PUC). A study Mello conducted with Vinicius Carrasco, PUC-Rio, showed that Brazilian regulation is of poor quality. The study analyzed 2009–11 data from 1,474 regulated firms in 62 countries; Brazil was positioned below the average for the countries studied. "For regulated firms in Brazil, institutional and regulatory risk exacts a premium [expressed as a higher return on investment] between 2 and 2.7 percentage points, which are fairly large," Mello said.

High freight costs make exports less competitive

One of the most common strategies of governments to stimulate exports is negotiating trade agreements that reduce or eliminate import tariffs. A study by the Inter-American Development Bank (IDB) points out however, that Latin American countries have much to gain by incorporating as a trade objective reducing the costs of bringing products from factory to port. "Currently, the cost of freight is much higher than the tariffs," said Mauricio Mesquita Moreira, economist, IDB Department of Integration and Trade. "In Brazil, for example, each percentage point reduction in domestic logistics costs could mean an increase of 4% in exports."

According to Moreira, who attended the seminar on infrastructure, one of the motivations for the study was to assess whether logistics costs could influence the regional concentration of exports. "Only 19% of Brazilian municipalities, representing 27% of the territory, export, and the top 10 account for 55% of total exports," he said. Moreira noted that there have been good plans and diagnostics for improving logistics infrastructure in the region, but the lack of political independence, technical expertise, and project coordination compromises execution.

Different modes, similar problems

Joísa Campanher Dutra, coordinator, FGV Center for Studies in Regulation and Infrastructure, has analyzed the financial viability of road concessions. She pointed out that discussion of the rates of return has been central to current negotiations. "Road concessions between 1994 and 2000 resulted in rates of return between 18% and 20%, whereas in the 2007 auction, the return declined to 9%. Now, participants are looking for ways to improve the return," she said. Dutra reminded the audience that road concessions require a large number of renegotiations because of withdrawals or failure to execute, which indicates a need to reconsider the criteria for granting concessions. She noted that "New concession contracts are beginning to emerge that incorporate temporal incentives to concession agents, who are penalized by delays, and give them a premium if they finish before the agreed deadlines."

> **"When regulatory quality improves, investors are willing to pay more for the same amount of profit."**
> ***João Manoel Pinho de Mello***

Armando Castelar, IBRE coordinator of applied economics, pointed out that, since railways were privatized, the sector has grown in volumes transported, revenues, and investment, while reducing the number of accidents. "Between 1997 and 2012, railways increased their share in total volumes transported from 15% to 25%," he said, but he was not impressed by government's intention to improve the railway system. He noted that the reforms of 2011 and 2012 added a more intrusive and higher dependence on subsidized credit and tax exemptions.

As for airports, Claudio Frischtak, president, consultants Inter.B, said that Brazil lost an entire decade for expansion, "since most countries that have increased their airport infrastructure took advantage of the jump in demand to invest more." Frischtak pointed out that, of 59 countries surveyed by the World Economic Forum between 2001 and 2011, Brazil had the lowest ranking of perceived quality of air traffic. He said that airport concessions can be successful, though he recalled that an IBRE study conducted by Frederico Araújo Turolla found that the current concession contracts raise a serious competition problem because they require the Brazilian Airport Agency (Infraero) to participate in concessions with rights of veto and of access to all information.

Problems in sea and air

In the port sector, the problems are the same. "The Ports Law of June 2013 unlocks the investment process , although at a much less favorable time than if it had happened in the second half of the 1990s , when there were more resources," said consultant Eduardo Augusto Guimarães. "The law promotes adjustments to the regulatory

framework, but it does not make labor contracts more flexible," he said.

The situation is even more critical in the waterways sector. "We live in a scenario of low investment and institutional mess, "according to Carlos Campos, economist, Institute of Applied Economic Research (IPEA)." The Growth Acceleration Plan [PAC] and the National Plan for Logistics and Transport [PNLT] include 57 projects requiring US$9.3 billion in investments, but they rely almost exclusively on fiscal resources and are not being executed," he said, noting that the budgets for 2012 and 2013 authorized spending of US$540 million for transport, but through the first half of 2013 only US$10 million had been used.

"Road concessions between 1994 and 2000 resulted in rates of return between 18% and 20%, whereas in the 2007 auction, the return declined to 9%."

Joísa Campanher Dutra

IPEA's Mansueto Almeida also underscored the government's lack of capacity to carry out public works. "The federal government of the 21st century has lost the ability to perform investments quickly. The only thing government does well is grant subsidies," he criticized. "Every year a budget is approved above what will be executed: from 2004 through 2011 budget execution averaged 26% to 48%. By law, budget execution should only be lower if there is a drop in revenue, but we have become used to authorizing more than can be executed."

Mansueto and Frischtak questioned the excessive dependence on the National Bank for Economic and Social Development (BNDES) to finance infrastructure projects." How can countries that do not have a BNDES invest 5%, 6%, 7% of GDP in infrastructure?" asked Frischtak, pointing out that Brazil's capital markets and stock exchange are underdeveloped. "Tools like project finance are virtually nonexistent in Brazil, but are important if we look at the international experience," he said, citing the need to strengthen the role of insurance in risk sharing. He concluded, "Today, we have much government activism with the Treasury providing funds and the government absorbing risks—but honestly, innovating very little."

The budgets for 2012 and 2013 authorized spending of US$540 million for transport, but through the first half of 2013 only US$10 million had been used.

Politics, the global outlook, and economic adjustment

Fernando Dantas, *Rio de Janeiro*

IN MID-AUGUST, BRAZIL'S ECONOMIC TEAM must have breathed a sigh of relief after an extremely tense second quarter. At the time, it seemed that the U.S. economic recovery would dramatically increase interest rates in the U.S., extending indefinitely the turbulent devaluation of the Brazilian real and the currencies of other countries dependent on commodity exports.

At the same time, many feared a forced hard landing for China, the second largest world economy, whose growth could fall below 7%, which would affect prices for Brazil's commodities exports and complicate the financing of its growing external current account deficit. Finally, the street demonstrations in June seemed to have slashed the political capital of President Dilma Rousseff, raising the danger that the economy would become ungovernable. Prospects for growth in 2013 and 2014 were also dimming.

Today the outlook seems a little better. The *real* has been behaving more reasonably in terms of rising long-term U.S. interest rates, even before the September meeting of the Fed's monetary policy committee, the FOMC, which announced that it would not start to tighten monetary policy any time soon. This caused the yield on 10-year U.S. Treasury bonds to drop from 2.84% on September 17 to 2.65% on September 30, while the real appreciated from R$2.26 to R$2.22 against the dollar.

There are signs that the Fed's monetary policy will be dovish for longer than financial markets recently thought. This view was reinforced by the appointment of Janet Yellen as chairman; she has said that it is too early to roll back monetary easing.

China, too, has released a number of favorable economic indicators recently, and its country's leaders have shown themselves more willing to avoid an abrupt slowdown of the economy.

In Brazil, finally, the president's popularity has partially recovered, and the economic indicators have been better than the market expected: higher second-quarter GDP and retail sales in July, the Central Bank's index of economic activity in July, and lower unemployment in August.

External deficit risks

Good external and domestic news has increased the chances that Brazil will not undergo a dramatic adjustment of the external balance before the presidential elections in 2014. The external current account deficit in 12 months reached 3.6% of GDP in August and is likely to reach close to 4% of GDP if

there is no adjustment. In the past, a current account deficit of 4% of GDP would often trigger severe external financing crises. But although Brazil today is economically much stronger and possibly less vulnerable, there are still reasons for concern.

The economy's growth potential seems to have dropped from 3.5–4% during the Lula administration to 2%–3% in his successor's administration. The lower its growth, the less capacity the country has to sustainably repay the external financing necessary to cover external current account deficits.

According to IBRE researcher Armando Castelar, Brazil will at some point have to make the adjustment, after having exhausted the possibilities of the consumer-led growth that prevailed during the Lula administration. Castelar explains that reforms by the Cardoso administration in the 1990s made the Brazilian economy more efficient. After Lula was elected president in 2003, he retained the basic economic policy, and between 2004 and 2010 as Brazil's political risk fell and China's appetite for Brazil's commodities grew, growth accelerated.

There was a credit boom, but high unemployment and a devalued *real* at the beginning of Lula administration moderated inflation pressures. At the same time, imports shot up to meet growing domestic demand and helped to contain inflation. "Those were times of euphoria," recalls Castelar, noting that while employment and real incomes rose, inflation and interest rates fell. Higher tax revenues allowed for increasing public spending.

There are signs that the Fed's monetary policy will be dovish for longer than financial markets recently thought.

Unsustainable policy

Castelar explains, however, that consumption-led growth was unsustainable, since the resulting currency appreciation and higher incomes undermined industry's competitiveness, debt grew faster than incomes, export prices could not rise forever, and there were limits to how much the external current accounts could deteriorate.

As growth faltered, the Rousseff administration attempted without success to prolong the boom through a new policy template: monetary and fiscal policy both became expansionary, the exchange rate was devalued, credit was expanded to finance consumption, and an industrial policy of "picking winners" was adopted. Becoming much more interventionist, the government granted specific tax exemptions to stimulate consumption of cars and durable goods.

In 2012 it was clear that the Rousseff administration's new policies were not producing the desired results — growth was slow and inflation high. At the same time, the surprisingly buoyant labor market, with low unemployment and rising wages, ensured the president's popularity.

In general, the consensus was that economically and politically the problems were manageable and that re-election of

China has released a number of favorable economic indicators recently, and its leaders have shown themselves more willing to avoid an abrupt slowdown of the economy.

President Rousseff in 2014 was almost a foregone conclusion. In the first half of 2013 high inflation, reflected in a slowdown in consumer spending, slightly undermined the president's popularity, but the consensus remained.

Then a period of great difficulties came, from May through July. Concurrent worsening on several fronts related to the ability of Brazil to finance its external deficit led to the view that the country was being forced to adjust, which could have significant ramifications before the 2014 elections. The government has every interest in postponing the adjustment, but if there were a drastic loss of funding, that would not be possible.

For some, adjustment of the economy and external accounts means correcting distortions introduced into the Brazilian economy in an attempt to extend the boom of the Lula administration years or through a misguided ideological approach. Samuel Pessôa, IBRE researcher, argues that adjusting the Brazilian economy would involve less management of the exchange rate, a more forceful attack on inflation, and correction of artificially controlled prices, such as fuel. It would also be necessary to reduce lending by the National Development Bank, reopen the economy, end selective tax exemptions, and reshape concessions policy to make the contracts more attractive to the private sector.

Change in relative prices

José Júlio Senna, head of the IBRE Center for Monetary Studies, explains that the external current account deficit can be adjusted by making a substantial change in relative prices, which is the flip side of a real depreciation of the exchange rate, because "internationally tradable goods, especially manufactured goods, have become more expensive relative to nontradable goods, mainly services."

Between July 2011 and August 2013 the Brazilian real fell 50% against the dollar, but the relative price of tradables to non-tradables fell only 6.8%, making nontradable goods relatively more expensive.

The Brazilian economy has shown resistance to adjustment of relative prices. This may or may not be due to factors related to public policy. The fact is, however, that such adjustments are painful. It is not likely that at this point in time adjustment would be politically feasible; the government will not embark on it unless it becomes absolutely necessary.

External adjustment—a substantial reduction of the current account deficit, with a change in relative prices—involves the loss or at least containment of incomes and worker consumption.

However, for the change in relative prices to crystallize, it is necessary to prevent a spillover of inflation from tradable to nontradable goods. Therefore, monetary and fiscal policies have to be tightened, which will affect workers by containing income, consumption, and credit.

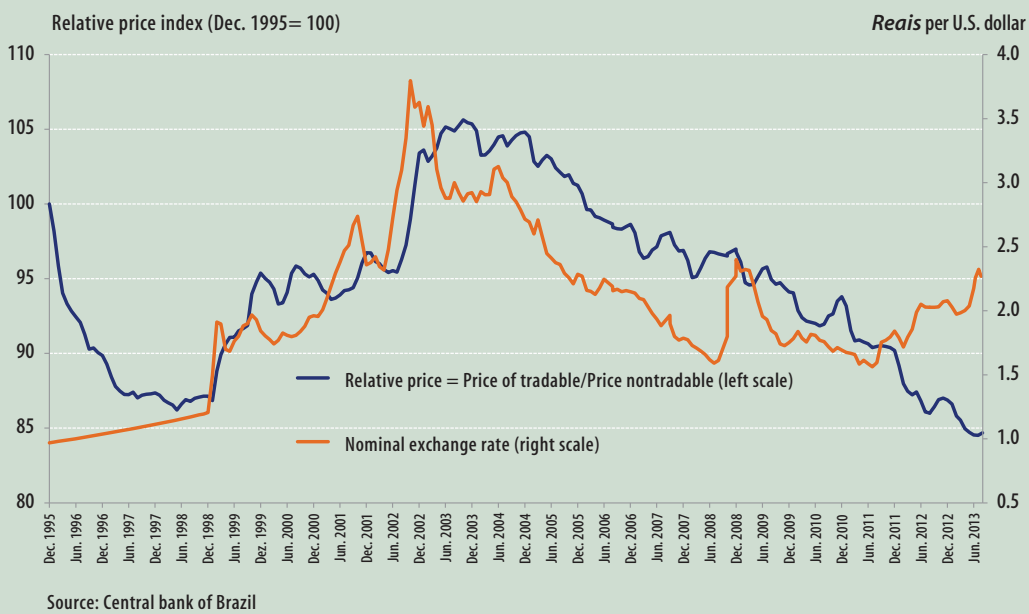
Curb consumption

Another way to reduce the external deficit is to cut domestic consumption and investment so that the country imports less and produces more surpluses for export. On the other hand, an increase in the relative price of tradables (induced by devaluation of the nominal exchange rate) makes them more profitable than nontradables. This is especially true because wages are a major factor in the cost of tradable goods.

Good external and domestic news has increased the chances that Brazil will not undergo a dramatic adjustment of the external balance before the presidential elections in 2014.

The increased competitiveness of internationally tradable goods affects manufactures in particular, since

Between July 2011 and August 2013 the Brazilian real fell 50% against the dollar, but the price of tradables relative to nontradables fell only 6.8%.



Source: Central bank of Brazil

The lower its growth, the less capacity the country has to sustainably repay the external financing necessary to cover external current account deficits.

commodities are more affected by international prices than by the exchange rate. Thus, the change in relative prices diverts investment and production to tradable goods, especially manufactures, allowing income and consumption to recover, with economic acceleration driven by external demand.

Pessôa calls attention to the fact that, by reducing the income of workers in favor of capitalists, who expand their margins in tradable goods, the change in relative prices actually increases the country's savings, since shareholders have more propensity to save than workers. Higher savings, in turn, makes the real exchange rate more sustainable and compatible with the process of enhancing investment due to the high profitability of the tradable sector. "Investment rises without the current account deficit doing so," says Pessôa.

External adjustment of this kind can be highly unpopular, especially in the beginning, because it would involve reducing worker incomes, increasing fuel prices, and reducing protection of domestic industry. That is why many analysts assume that Rousseff and her economic team will try to kick the can down the road until after the elections, and wait to promote deeper changes in the economy until 2015. The recent relief in the U.S., Chinese, and domestic economic indicators and returning presidential popularity reinforce this idea.

To Castelar, however, "there is a chance that, instead of making the adjustment in 2015, the government may double its bet" on current policies. He points out that adjustment of the economy carries very high political costs that may be unpalatable even after the election because initially it would reduce economic activity, raise unemployment, cut public spending, and raise interest rates and fuel prices.

Cumulative costs

Castelar notes that many of these costs are cumulative, and in some cases may rise due to unpredictable cyclical changes. For example, as U.S. monetary policy eventually normalizes, Brazilian interest rates will also have to rise, and the implicit subsidies in BNDES loans will increase. The more time it takes to bring inflation down to the 4.5% target, the more the credibility of the central bank suffers, and the higher inflation expectations become. That would make the job of the central bank all the more difficult and costly in terms of economic slowdown and rising unemployment. That is why Castelar warns that "adjustment may not make sense from the point of view of political logic, even in 2015."



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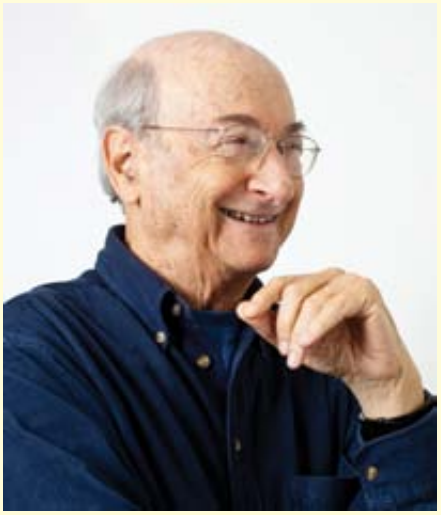
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Cities in transition



Jorge Wilheim

Architect and urban planner

Solange Monteiro, *São Paulo*

SEVERAL TOWNS MERGING with suburbs of one or more cities, traffic jams, and popular demonstrations—big Brazilian cities are in a constant state of bubbling, says Jorge Wilheim. This son of Italians, who lives in São Paulo city and is the creator of such city architectural icons as the Anhembi Park, argues that this process reflects a period of transition as society embraces the search for legitimacy, representation, and greater participation. He has also drawn up urban plans for Curitiba, Campinas, and Natal cities. Twice Planning Secretary of São Paulo city, during the administrations of Mario Covas (1983–85) and Martha Suplicy (2001–04), Wilheim criticizes several misguided policies that have prevented expansion of public transport in Brazil. He also argues that in planning, "It is necessary to transform space into place, which is the space to which you lend emotion. The essence of urban planning is that people in cities are there to have homes, live, produce, and study."

***The Brazilian Economy*—You were the author of the Master Plan that made possible the BRT (Bus Rapid Transit) in Curitiba. Why was the BRT so successful in Curitiba, and why we do not see the same success in other Brazilian cities?**

***Jorge Wilheim*—**The case of Curitiba is based on a very simple axiom: where there are a lot of people, public transport is essential. The relation between population density and transport is obvious. So I identified where the important city corridors were, and there I placed dense zoning to allow more people to live in the region, and adequate roads for bus transportation. What happens in other cities . . . is weakness in both the planning system and the vision in relation to market forces that pull back and forth, twisting things that are natural and obvious.

Why in other cities, such as Bogota in Colombia, has the BRT been successful?

In Bogotá, the city administration expropriated an area four times larger than the one in Curitiba. The width of the Trans Millennium, the BRT system, is huge. It can fit in many lanes for cars as well as buses and very wide sidewalks. That has not happened in Curitiba on the same

scale. In Bogotá they bet that it will not be necessary to have metro rail in future, but I think it will be. Today I'm afraid to do a survey in Curitiba to know how many people who live next to the BRT system use it . . . . My guess is that, although the public transport runs close to many apartment buildings, the purchasing power of the middle class and the prestige of owning a car have not been sufficiently counterbalanced by the traffic congestion. Traffic is heavy in Curitiba, but it has not reached the levels of acute traffic jams, as in São Paulo and Rio de Janeiro.

"With a car we can go when we want, where we want, and with whom we want . . . . This attachment to freedom is innate in humans, and the car symbolizes that."

Today there is greater awareness of the need to make public transport a priority. Do you think the major cities are investing adequately in public transport?

First, keep in mind that the automobile is an object of desire. Luigi Pirandello said that the automobile is an invention of the devil. It is beautiful, it is sensual, and it gives a sense of freedom. With a car we can go when we want, where we want, and with whom we want . . . . This attachment to freedom is innate in humans, and the car symbolizes that. . . . Henry Ford used to say "There's a Ford in your future." Big brand advertising from the beginning of the automobile in the 1950s really drew on our belief that there's a car in our future.

Second is the question of credit. It was interesting that the Brazilian government, facing the 2008 crisis, decided to carry out countercyclical policies. At that time, President Lula was the most Keynesian of Keynesian. And he hit it. He gave credit to automotive and construction industries. Of course this increased the number of automobiles on the streets, just as it increased the number of buildings . . . .

But we cannot blame the Brazilian government for traffic congestion. Even if there hadn't been a recent increase in automobile sales, the number of cars no longer fits on the roads of São Paulo or Rio de Janeiro . . . . We had misguided policies that have caused huge underdevelopment throughout the country. The abandonment of the railroad in Brazil was a clear mistake. But today the transport gap is further complicated by increased traffic jams. Today there is initiative [for investment in public transport] . . . . We must demand that these projects and investments are made.

"We had misguided policies that have caused huge underdevelopment throughout the country. The abandonment of the railroad in Brazil was a clear mistake. But today the transport gap is further complicated by increased traffic jams."

Today, there seems to be awareness that improvements in transport should go along with attracting more people to live in the center and more economic activity to the periphery. However, cities like São Paulo should be thought of as a macro-metropolis, encompassing Campinas, Santos, Sorocaba, and São José dos Campos. Is there any possibility of policy changing to encourage inter-municipal planning?

We are prepared to discuss it—but not to operate it. The macro region of São Paulo has about 24 million inhabitants, of whom about 3 million move daily between home and work. But both people and institutions tend to be conservative; only urban dynamics and life itself forces them to change — through crises, chaos, and revolutions. Nothing happens a minute before. We must take into account that the difficulties of urban management take in more than just space planning . . . . The major change [in public administration] is to work for a program. If the issue is traffic jams, it is clear that the Secretary of Transportation participates, but it is also true that the Secretaries of Housing, Industry, Trade also participate. In addition, the Communication Secretary, users, and NGOs should participate. Once the traffic jam problem is resolved, the network dissolves. Another program may derive from this, but the grouping of people will be different. Private companies work that way. In the public sector it is more difficult because politicians want to preserve their power. But we must learn to manage that way.

"Both people and institutions tend to be conservative; only urban dynamics and life itself forces them to change — through crises, chaos, and revolutions. Nothing happens a minute before."

In urban planning, you advocate that it is more important to worry about anthropology than statistics. Why?

What is urbanism? It is the art and science of cities. Cities are large urbanized regions . . . . People are coming here to live, produce, and study. The quality of that life is what matters for humans. You have to analyze how people live — not only identify major groupings and make statistical surveys but know the heart of this life. Rio inhabitants do not live the same way as those in São Paulo, who do not live the same way as inhabitants of a small town in Minas Gerais. You need to understand what the fundamental systems of life are and give quality to them. Mobility, which is necessarily in fashion, is important, but the quality of transport is also important . . . . So urbanism has to have a view of life and people in their activities. That is why it is

"What is urbanism? It is the art and science of cities."

necessary to transform space into place, to have spaces that mean places. You measure space, and space is the place to which you lend emotion, that you choose for your activities, you adopt into your life.

Do you consider yourself optimistic about the moment the country is experiencing?

I am an optimist. I think the street demonstrations were important and will not stop. They were a qualitative leap in participation; however, in appearance it has been chaotic. Of course, if it stays chaotic, it will dissolve. But I have hope that it will end in positive pressure on political leaders.

It is also good to remember that not everything that has happened in our cities so far has been negative. Some people miss the past. I came to Brazil in 1940. I was impressed with the number of kids and adults in the streets barefoot . . . . It was a state of poverty I did not know. To say that the past was better is not true. The country has moved. Let's remember that at the time of the Proclamation of the Republic, 130 years ago, 80% of the population were illiterate. What degree of politicization could you aspire to if there was no way to communicate in writing? At the time of the Industrial Revolution, the life expectancy in England was 41 years. Today, it has nearly doubled, and in Brazil as well. By no means was the past good.

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Brazil's economy is on hold, and policy changes are unlikely before the election. IBRE maintains its forecast of a 0.4% contraction in third-quarter GDP quarter-on-quarter and 2.5% growth for 2013.

IN RECENT WEEKS THE PERCEPTION has risen that the government is unlikely to make changes in economic policy in the short term, despite the slow pace at which the economy is likely to move through December.

Consumer inflation has been artificially repressed. The government is possibly awaiting a suitable time to make some adjustment in domestic fuel prices that might permit the central bank to achieve an inflation rate lower than in 2012 or at least just under the inflation target ceiling of 6.5%. The fact that inflation in the third quarter was lower than expected should allow the government to reduce part of the gap between international and domestic fuel prices.

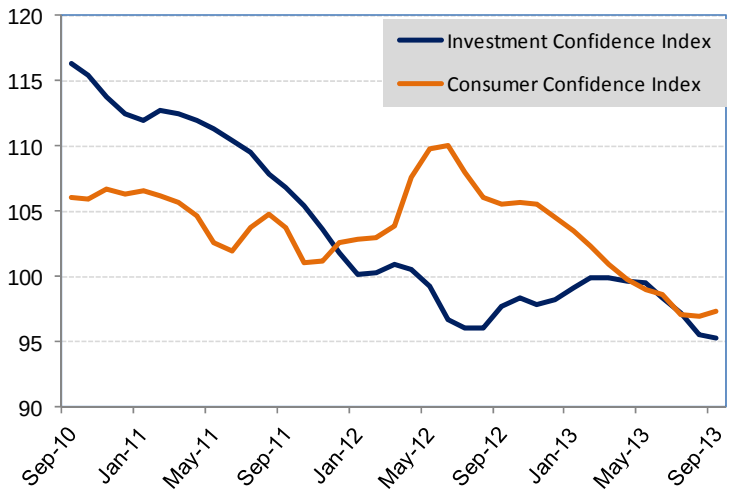
The central bank has continued its monetary tightening, gradually increasing its policy interest rate to contain inflation. Food inflation has slowed, but services inflation remains high and suppressed administered prices such as fuel prices are a concern.

Three fiscal policy developments have stood out in recent weeks. First was the announcement that the Treasury would reduce new contributions to the National Development Bank, which has significantly increased its loans to the private sector. Behind this announcement may be the fear that Brazil is risking a downgrade of its ratings by the international rating agencies. Second was the government's attempt to maintain the primary budget surplus to prevent an increase in public debt, even if it has to resort to extraordinary measures. Third was the government's recent decision to change the repayment terms for state debts. This sets a dangerous precedent in that it will allow states and municipalities to increase their expenditures in 2014, an election year.

Abroad, the international economy continues to recover slowly, though now the prospects of growth in the medium term in developed countries and slower growth in emerging countries like Brazil are clearer. At the same time, the world is still on hold because of uncertainty about the speed at which the U.S. Federal Reserve will phase out the extraordinary monetary expansion, which could well increase the volatility of currencies, including Brazil's. The impasse in the negotiations between the U.S. executive and the legislature regarding the budget and public debt ceiling also increases the volatility of international currencies.

Meanwhile, uncertainty still prevails among the business community and consumers, increasing the possibility of a significant reduction in Brazil's GDP in the third quarter. The end of the third quarter shows a further decline in business confidence. Rising interest rates, weakening domestic demand, and slowing investment have significantly altered the mood of the business community. There is also deep consumer concern about inflation and employment prospects.

Declining confidence points to a fall in GDP growth in the third quarter.



Source: IBRE/FGV.

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