THE BRAZILIAN ECONOMY

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Brazil's growing pains

Brazil needs saving, investment, and productivity if the economy is to grow sustainably.

Argentina raises new barriers to Brazilian imports.

Albert Fishlow: "The new Brazil must face the world."

Ricardo Lagos Weber: "Brazil's Foreign Ministry does not like our policy of trade integration."

Politics

President Rousseff's congressional reform agenda.



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The BRAZILIAN ECONOMY

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ECONOMY

Industrial activity grows 2.2%

Industrial activity grew by 2.2% in November, breaking a string of negative results, according to the National Confederation of Industry. Industry operated at 81.5% of its capacity, as it did in October. Hours worked increased by 0.2% compared to October and employment was stable. (January 16)

Consumer confidence falls in January

The Consumer Confidence Index, compiled by the Getulio Vargas Foundation (FGV), was down 3% in January compared with December. The proportion of consumers assessing the local economic situation as good declined from 27.1% to 24.4%, and the share of consumers intending to buy durable goods within six months fell from 19.5% to 15.9%. (January 25)

Credit growth accelerated at year-end

Growth in bank lending rose from 18.2% year-on-year in November to 19.0% in December. However, bank balance sheets could be vulnerable to deteriorating asset quality as households became more indebted in the past five years. Household debt as a share of yearly income has already gone from 25 percent to over 40 percent. (January 25)

Federal public debt grew in December

The National Treasury reported that federal public debt, domestic and external, grew 10% in December 2011, reaching R$1.86 trillion. Domestic debt increased by 11% to R$1.78 trillion; external debt fell by 7.6%, to R$83.3 billion. (January 30)

POLITICS

Farewell to another minister

Minister of Cities Mario Negromonte is the seventh minister in Rousseff's cabinet to step down because of corruption charges. He has been accused of awarding public work contracts to companies that financed his party—allegations he denies. (February 2)

INFRASTRUCTURE

Airport sales prices higher than expected

The government raised R$24.5 billion (US$14.4 billion) from the sale of airports in Guarulhos, Campinas, and Brasilia—347% higher than the R$5.5 billion initial bid. The private sector will have a 51% stake in new companies that will manage the airports and state-owned Infraero will keep 49%. The concession period is 20 years for Guarulhos airport, 30 years for Campinas, and 25 years for Brasilia. (February 6)

JUDICIARY

Supreme Court sustains CNJ powers to investigate

The Supreme Court ruled 6–5 that the National Council of Justice (CNJ) could retain its investigative powers. The decision validates the power of the agency to open investigations against magistrates without relying on local internal affairs units. The decision reverses an injunction granted by Justice Marco Aurelio Mello to the Association of Brazilian Magistrates. (February 2)

DEFENSE and SECURITY

Brazil and Colombia cooperate on defense

The defense ministers of Brazil, Celso Amorim, and Colombia, Juan Carlos Pinzón Bueno, announced creation of the Binational Commission of Defense on January17 in Brasilia. The objective is to increase the exchange of information between their intelligence agencies, especially about the Amazon and regional crime. Officers in the armed forces of each country will meet in the next two months to discuss details. (January 17)

ECONOMIC POLICY

Central Bank cuts benchmark interest rate

Confirming expectations, for the fourth straight time the central bank reduced the benchmark interest rate by 50 bps, to 10.5% . The central bank said that moderate rate adjustments were consistent with reducing inflation to the 4.5% mid-point target this year. (January 18)

Mantega: Fiscal tightening will help lower interest rates

The Brazilian government's policy of controlling spending will help give the central bank room to further reduce the interest rate, Finance Minister Guido Mantega said Thursday in a conference call with reporters. President Rousseff has said the administration wants the interest rate to fall to levels in other developing countries, and the government passed a budget late last year that reined in discretionary spending. (January 26)

Brazil meets 2011 budget target, worries ahead

Brazil comfortably met its primary budget surplus target in 2011, official data showed. In President Rousseff's first year in office, Brazil posted a record primary budget surplus of R$129 billion (US$73 billion), equal to 3.1 percent of GDP, the central bank said. The strong fiscal performance, helped by rising tax revenue even as the economy slowed, stopped a two-year stretch of government spending growth under former President Lula da Silva to shield Brazil from 2009 global financial crisis and during the 2010 electoral year. However, growing spending pressures from a mandated 14 percent minimum wage hike and a likely drop in taxes collected will make it harder to achieve this year's 3.1 percent primary surplus target. (January 27)

FOREIGN POLICY

Patriota meets with UK Foreign Minister
Foreign Minister Antonio Patriota and British Foreign Minister William Hague met to address trade and reform of the UN Security Council. Patriota said that Brazil highly values UK support for the free trade agreement between the EU and Mercosur and said he expected the negotiations to move this year. Hague said also that expanding trade between Brazil and the UK is a priority for the British government. He also expressed support for reform of the Security Council and Brazil's hope of a permanent seat on it. (January 18)



Photo: Valter Campanato/ABr.

Foreign Ministers William Hague (left) and Antonio Patriota at press conference.

Foreign Minister pledges more money for the IMF
At the World Economic Forum in Davos, Foreign Minister Antonio Patriota reiterated Brazil's readiness to contribute more to the IMF to help resolve the euro crisis. However, he repeated that the contribution would be conditioned on the euro zone taking measures to resolve its crisis and restore growth. (January 27)

Rousseff focuses on trade on Cuba trip
President Rousseff visited Cuba on January 30 in a bid to expand economic ties. There she discussed the US$800 million project to renovate Havana's Mariel port, largely funded by Brazil's development bank and Brazilian building company Odebrecht. She also signed several science and technology agreements. The Brazilian government will open a $350 million credit line for Cuba to finance food purchases and another for $200 million to purchase agricultural equipment. Rousseff reiterated her support for a global commitment to human rights; she did not comment on alleged violations by Cuba but did criticize the U.S. prison base at Guantanamo and the 50-year-old U.S. embargo on trade with Cuba. (January 30)



Photo: Roberto Stuckert Filho/ABr.

President Rousseff (left) and Cuban President Raul Castro

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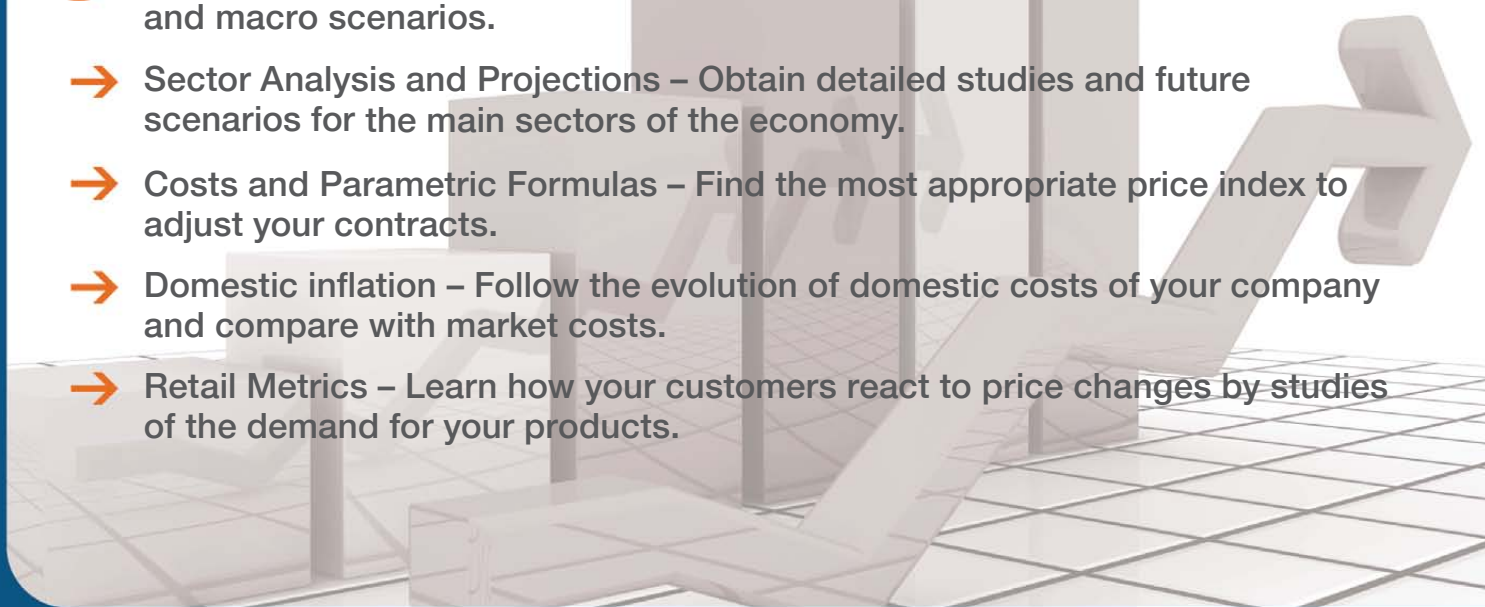

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Remember the neighbors?

Brazil taking her proper place in the world is a hot topic of conversation, but how effective can Brazil be in the world when virtually no one believes it's functioning well even here in the region?

We could say there's ambiguity about Brazil's place in the region, except that there's nothing ambiguous about the fact that Argentina has just adopted yet another protectionist measure against Brazil, its biggest trading partner, even though that seems likely to boomerang on her own manufacturers. It's hard to find ambiguity in the words of Chilean senator Ricardo Lagos Weber, previously a trade negotiator and President Michele Bachelet's chief of staff, who says, "It's no secret to anyone that Brazil's Foreign Ministry has never liked our policy of trade integration," and then goes on to describe the new Pacific Alliance of Chile, Peru, Colombia, and Mexico.

Is Brazil doing exactly what it complains about the U.S. doing? Talking the talk about the importance of Latin America but not walking the walk?

Nor does anyone have much good to say about Mercosur. Long-time observer of Brazil Albert Fishlow says, "In the 1990s Mercosur was a basis for the economic expansion for both Brazil and Argentina. But in the past decade, it lost importance, particularly for Brazil." And Lagos Weber unambiguously calls Mercosur "a complete failure" mainly because it's not properly structured, which indicates "it has no interest in its members."

So: Is Brazil doing exactly what it complains about the U.S. doing? Talking the talk about the importance of Latin America but not walking the walk?

That's just one—big—question. Another is how long it will take for Brazil to recognize the competition that's building in the region. Fishlow points out that Brazil lags behind Chile, Argentina, and Mexico with regard to domestic resources for investment. He also points out the above-average growth in Colombia and Chile, which could allow Brazil to expand its exports—but could also make those two countries bigger competitors, especially as they diversify their own exports. In discussing the Pacific Alliance Lagos Weber describes how its members are actually reorganizing to benefit from trade integration—something that clearly has never happened with the members of Mercosur. He comments that for Brazil exports make a negligible contribution to GDP because of its huge domestic market. But balance matters. Or it should, especially considering how much talk there is in Brazil about exports and the possibility that losing markets may cause deindustrialization.

Lagos Weber mentions that when he was a trade negotiator, the only area where he was not active was Latin America "because there was nothing to do." And despite a lot of pious declarations our authorities seem to be acting as if today there's nothing for Brazil to do in Latin America.

Fishlow thinks that Brazil is now in a good position "to look further into the future." His first recommendation is that "the country should maintain links with Latin America." And despite his criticisms, Lagos Weber says, "Brazil has weight, and therefore must exert leadership." The real question, then, is how much leadership Brazil can exert in the region when it's so focused on what is happening and could happen with China on the other side of the Pacific that it's unable to see what is happening across the borders.

Rousseff's congressional reform agenda

President Rousseff begins 2012 with enough political capital to manage any tensions within her governing coalition. But what are the prospects that she will use some of that capital to get more done in Congress? And, if she does, what might be on her legislative agenda?

João Augusto de Castro Neves, Washington D.C.

Having navigated turbulent waters, President Dilma Rousseff's administration ended its first year in a safe harbor. Although critics complained of a constant and somewhat disruptive turnover of cabinet appointees (seven in 2011), the government succeeded in highlighting to the public the message that it was determined to fight against corruption. As for the economy, some considered the central bank's decision to lower interest rates despite inflationary pressure to be a risky gamble that could disturb the balance of economic policy. The continuing global economic slump, however, increased the odds that the new strategy would be successful, and inflation remained under control despite the monetary easing.

President Rousseff's popularity numbers therefore come as no surprise. With over 70% approval ratings according to a recent poll, the president was able to improve her political standing during her first year in office. As a result, she begins 2012 with enough political capital to manage any tensions within her governing coalition.

One question, however, has yet to be answered: Will Rousseff do anything with her political capital besides deflect crises? There are two clouds on the horizon: First, though her popularity is well above the average for a healthy administration, the uncertainties of the global economy may take their toll on economic activity at home. Second, local elections are looming large; they may put the governing coalition through a stress test in the second half of the year.

On the legislative front, though, the question is really about President Rousseff's reform agenda. Survival is not necessarily the same thing as strength. Though Rousseff's favorable standing undoubtedly protected her administration from friendly fire, whether it will be equally effective in terms of working through her agenda is yet to be seen. Despite some important victories, the dynamics of

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legislative activity throughout much of last year were slower than usual. Apparently, Rousseff allocated more political capital to managing tensions between allies than to easing negotiations in Congress.

With this in mind, what can be expected when the Brazilian Congress reconvenes this month? The legislative calendar is tight due to local elections in the second half of the year, and the coalition infighting is likely to persist (one more minister resigned this year amid allegations of corruption), but the setting is reasonably favorable for Rousseff to push forward a reform agenda. The president's congressional leadership established the priorities earlier this month. These are the main items on the government's legislative laundry list—items that will certainly draw attention from the media and in political circles but that also stand a reasonable chance of moving forward this year:

- **Public pension reform:** The proposed law would replace the current pay-as-you-go pension scheme for new public servants with individual accounts in which the government matches employee contributions.
- **Oil royalty distribution:** This would establish a new method of allocating revenues from oil production between the central government and local governments. Its approval is a prerequisite to exploitation of the deep sea oil fields.

One question, however, has yet to be answered: Will Rousseff do anything with her political capital besides deflect crises?

- **New mining code:** This overhauls the law relating to the sector: It creates a new regulatory agency and is also likely to raise federal revenues from taxes and royalties.
- **Tax reform:** A particularly important aspect of this reform is that it would simplify the state-based value-added tax, which would end the tax-cutting competition ("fiscal wars") between local governments to attract businesses.
- **Forest code:** The draft reduces the amount of forest cover that rural landowners need to maintain on their properties and expands exemptions for landowners with the smallest properties.
- **World Cup legislation:** This would temporarily adjust national and local sporting legislation to comply with the requirements of the international soccer organizing body.
- **State and municipal participation fund:** This would reestablish a federative agreement between the central government and local governments on the distribution of tax revenues. The current fund is scheduled to expire late this year.

Brazil's growing pains

Brazil needs saving, investment, and productivity if the economy is to grow sustainably.

Claudio Accioli, Rio de Janeiro

Which formula is best? Increase public investment to stimulate the growth of the economy, reduce the budget surplus target, and risk interrupting the decline of the benchmark interest rate? Or sacrifice growth to meet the surplus target, and hope that falling interest rates will eventually reduce payments on public debt enough to clear space for more public investment? This dilemma is what is dividing opinions in the Rousseff administration today.

A new Brazilian Institute of Economics (IBRE) study shows that if current macroeconomic conditions prevail, the GDP growth rate that would allow the economy to grow without inflation is 2.8% for 2012. Even compared to other emerging countries, Brazilians and their government save and invest little and are not very productive. The average savings-to-GDP ratio was 18.9% of GDP between 1970 and 1979 and today it is still just about 18%. Meanwhile, China has pushed up its ratio from 27% to 43%, India from 18% to 28%, and Vietnam from 22% to 33%. A comparison of average investment is similar: Brazil is out-invested by all three countries.

IBRE estimates that if investment in Brazil increased from the current 20% of GDP to 25%, even if productivity stayed flat, potential GDP growth would reach 3.6%; if productivity rose by 1%, with no change in investment, potential GDP growth would be 3.8%.

The situation is even more grim with regard to investments in infrastructure, which are crucial for sustainable economic growth. Between 2001 and 2010, investment in Brazil, primarily on electricity, telecoms, and roads, averaged only 2.3% of GDP. Even at the peak of the government's Growth Acceleration Program in 2010, total investment was only 2.5% of GDP—1.5% invested by central government and public enterprises and 1% by the private sector.

"THE MOST SERIOUS PROBLEM"

According to the World Bank, "investing less than 3% of GDP is not enough to cover the depreciation of fixed capital," says economist Claudio Frischtak, president of InterB, an international business consultancy. "In 2009–10, India invested 4.8% of GDP in infrastructure, and China invested 13.4%. Chile invests around 6%, and Colombia 5%. Comparatively, Brazil is an outlier."

To invest, you need to save. And here Brazil falls very short. Historically, households, businesses, and government have saved little. "The most serious problem of the Brazilian economy is the lack of domestic savings," says Albert Fishlow, an expert on Latin America (see interview, page 16). "Brazil is behind Chile, Argentina, and Mexico in the availability of domestic resources for investment. We must reverse past practice. The government should save, instead of just spend."

"Between 1981 and 1983, there was a collapse of investment, and Brazil has never recovered," says economist Edmar Bacha, former president of the Brazilian Institute of Geography and Statistics (IBGE) and the National Bank for Economic and Social Development (BNDES). And, he adds, "The high levels of investment at the end of the 1970s were supported by an inconsistent model based on foreign savings on one side, which generated great debt, and on forced savings through inflation on the other."

THE SAVINGS HABIT

Why has Brazil historically saved so little? Like the United States before the global crisis, says Luiz Carlos Mendonça de Barros, a former president of BNDES and partner of Quest Investments, "Brazil is among the countries where household savings are too low and consumption too high." But, he explains, the habit of saving as the Japanese and Chinese do "is a very strong social value" and whether you are a saver or not a saver, the habit is difficult to change. Moreover, Brazilians have demanded a policy of income transfers to the poor to relieve the country's unequal distribution of wealth and historical deficiencies in education and health services. The social security scheme does not favor savings

The situation is even more grim with regard to investments in infrastructure, which are crucial for sustainable economic growth.

IBRE consultant Samuel Pessoa questions whether Brazilian society is really interested in changing the current model, whether it needs to, and if so, what would be the right time. He argues that, as the majority through elections has shown a preference for income transfers, for Brazilians economic growth is apparently not a priority. "Growing more means depriving yourself of things now to have a future benefit. This applies to both the individual and the society," he says. The trade off cannot be imposed; it has to be mediated by a

To invest, you need to save. And here Brazil falls very short. Historically, households, businesses and government have saved little.

democratic process. Pessoa adds that, since the administration and Congress seem to be doing what the public wants, "it is reasonable to assume that Brazilian society is satisfied with their choice." Further, he says, to change, "there must be political debate, and we see no candidate advocating alternative proposals."

Frischtak agrees that one reason for the sluggish growth of the Brazilian economy is society's decision to choose income distribution but thinks the problem is in how the model is applied: "The 1988 Constitution establishes a better income distribution compact, but certain policies are not covered.

There are distortions in public pensions, corruption, and waste of money: There are billions of dollars misallocated that are not part of the income redistribution compact. If these expenses were more rational, there would be resources [for investment], regardless of income transfers to the poor and elderly." He also disagrees vigorously with the idea that Congress reflects society's choice. A major weakness for Brazil, Frischtak says, is "the bad example of our political elites, who generally give poor examples of conduct, and the deterioration in the quality of our Congress, which is far from mirroring the nation, which leads to a certain disillusionment with democracy."

WHERE EDUCATION FITS IN

Bacha also questions whether Congress faithfully represents the minds of voters. He thinks it tends to transfer more benefits to interest groups that have more lobbying power than the average voter. "The Brazilian government allocates almost 25% of GDP to social spending, including education, health, security, social security, and incomes policy. But most social security pensions go to public sector employees and higher income earners rather than to the poorest. And we spend five or six times more on college education than on basic education. Except for programs like the Family Grant, our social policies do not represent an actual transfer of income from the rich to the poor. This is not a social pact, it is an elite pact." Bacha favors "a radical process of containment of current expenditures by the government to increase capacity for public investment."

Barros argues that "We need to increase competitiveness and investment through modernizing institutions, tax cuts, and more efficient government." Instead, he says, "what we have achieved in recent years was a precarious balance between domestic and foreign savings and the volume of investment possible in an unfavorable environment." He points out that the significant growth in consumption observed in recent

years, thanks to the policy of raising the minimum wage in real terms, brought no additional investments in infrastructure and human capital: "There are shortages of skilled labor that can only be corrected through investment in public education."

Pessoa is also concerned about education. "There are several measures that could be taken to reduce the cost of building infrastructure in Brazil. But … we lack know-how." He adds that transforming the Brazilian model from a consumption to a saving society may be induced through the ballot box by the emerging middle class: "If economic growth, even mediocre, lasts for many years, the emerging middle class will tend to separate from the poorest classes and worry more about the problems of the Brazilian government, especially infrastructure and public services. The emerging middle class will have cars and they will complain of congested streets, they will aspire to upward social mobility for their children and they will find that public education is unsatisfactory. At that point, increasing investment and improving the quality of public services will become a priority, creating a political agenda that leads to growth."

Pessoa sees no reason for urgency in this process: "We have bottlenecks, discomfort, which will addressed as the physical infrastructure deteriorates. The ports work and trade is growing." Frischtak disagrees: "The more we wait, the higher the cost. And people are increasingly dissatisfied with the quality of collective goods."

To raise Brazil's growth rate sustainably . . . it is necessary to go through the private sector, especially when it comes to infrastructure.

BEST OF BOTH WORLDS?

Nor is there any consensus on the ideal rate of growth for the Brazilian economy. "There isn't an optimal growth rate," Pessoa says. "The ideal rate is the maximum possible," replies Barros, adding, "It is perfectly possible to see sustainable growth of 5% or 6% a year—once the right policies are adopted."

Frischtak is more skeptical about very rapid growth rates: "If you ask me if it's a good idea for Brazil to grow 8% or 10% a year, I would say no. In my opinion, the ideal growth rate would be about 4% to 5% of GDP, consistent with the improved well-being of the population and capable of projecting Brazil abroad adequately but not putting excessive pressure on natural resources." Bacha recalls that Brazil has managed to grow at rates between 7% and 7.5% of GDP for long periods in its history. In theory, he says, that growth rate would be the ideal, and a World Bank study seems to suggest it would be a reasonable objective for developing countries. However, he cautions, "when Brazil was growing at

Why has the corporate savings rate not increased in Brazil? Possibly because taxes penalize production and investment.

7% or 7.5% a year, the population was growing at 3%. Now, the population growth rate has fallen back to about 1%, so if we could grow at about 5% or 5.5% … in per capita terms [that] would be replicating the best times, from 1940 to 1970."

But how do we get there? Here there is more convergence of views. There seems to be general agreement that to raise Brazil's growth rate sustainably, through increased savings and investment and productivity gains, it is necessary to go through the private sector, especially when it comes to infrastructure. Barros notes that large firms in Brazil tend to be highly profitable because of an uncompetitive economic environment, and they mainly finance their investments through retained earnings. Yet there is evidence that aggregate corporate savings have been stagnant as a share of GDP in recent years. "In China," Barros says, "the increase in savings from 40% to 50% of GDP in the last decade was due mostly to corporate savings. The same pattern occurs in other countries. So why has the corporate savings rate not increased in Brazil? Possibly because taxes penalize production and investment. So one way to boost corporate investment and savings," he argues, "would be a massive program of tax cuts."

Industry is a worry for Pessoa, however: "It is easier to grow based on industry than on services, because industry can generate income and productivity even if human capital is not qualified, but the service sector depends more on skilled personnel." Because the economic agenda gives priority to social justice at the expense of savings and growth, he says, the services sector is likely to grow relatively more than industry in coming years. "That means we will have a service sector with low education," he warns. Frischtak thinks, however, that productivity gains are possible without compromising the social agenda—if the government's planning is of reasonable quality. "If the public sector does not hinder, and improves sectoral planning, including appropriate regulation and privatization of critical assets, it will be enough to support an explosion of private investment," he believes. "We can keep the social compact of 1988 and at the same time boost investments in infrastructure in Brazil without touching a penny in public resources."

PRIVATE SECTOR CAPACITY

The country will not be able to raise its growth rate quickly. Barros points out that "The Brazilian government has a very high level of current expenditures, especially considering taxes of 35% of GDP. Therefore, to maintain a primary budget surplus that stabilizes the debt-GDP, it must run a very low level of

investment. The result of this precarious balance of public finances is even more pernicious considering that to get to it, the government overtaxes Brazilian companies," says Barros. In the case of infrastructure, Frischtak argues that even if the government could expand its capacity to save and invest, the scenario would change very little. "If Brazil can double investment in infrastructure from 2.5% to 5% of GDP over the next five or eight years, we will make a small revolution," he says. "Is it enough? No, but we should not dream of 8% or 10% of GDP. It turns out that to achieve this 5%, even if it reduces its nominal debt, increases savings, and reallocates resources, the public sector would increase its investments by 1% of GDP to 2% or 2.5%. So most of the increase in investment has to be done by the private sector, not only because of the government budget constraint but also for the sake of efficiency in resource allocation."

Frischtak, Barros, and Bacha also agree that without tax reform and with the policy of cuts in current government spending, the most efficient way to increase public sector investment would be to deepen the privatization program and grant concessions in the areas of services and infrastructure. "Look at the case of airports," Frischtak suggests. "The private sector should have been investing in airports for over 20 years, but only now, because of major events—World Cup and Olympics—is the first auction coming up. With regard to ports, state-owned dock companies, with rare exceptions, are not doing a proper job and should have been privatized long ago." Barros adds, "The government is beginning to acknowledge slowly the need to attract the private sector, as shown by the auction of some federal roads and airports. But it always moves shyly. In the case of airports, the government is demanding that the government company that manages airports (Infraero) retain up to a 50% stake, which is obviously a burden to anyone interested in participating in airport concessions. In the case of roads, some toll rates are so low that they make private investments unfeasible."

The most efficient way to increase public sector investment would be to deepen the privatization program and grant concessions in the areas of services and infrastructure.

Bacha believes that the problem is mostly at the federal level. "Public-private partnerships are stalled in the federal government but have proliferated in state governments, which are closer to the everyday population, especially in the areas of health, education, and public works. Then, something moves. The problem is how to make things move in Brasilia."

"The new Brazil must face the world"



Albert Fishlow

Economist; professor emeritus, Columbia University and the University of California, Berkeley

Claudio Accioli, Rio de Janeiro

More than four decades ago the American economist Albert Fishlow started studying Latin America, with special attention to Brazil. He observed the developmentalism of the 1960s, the economic miracle of the 1970s, the countless crises of the 1980s, and the early recovery in 1990s (led by one of his students, former finance minister Pedro Malan). Last year he published his observations of the last 25 years of Brazil's history in his book *The New Brazil—Political Achievements, Economic, Social and International Relations.* Here Fishlow analyzes the country's prospects and the global economic outlook. With regard to Brazil, he maintains his customary optimism but warns: "You have to grow sustainably in coming decades, which means raising per capita income through increased productivity, not by raising the minimum wage."

***The Brazilian Economy*—Even when there were serious economic problems, you have always been confident about the resilience of Brazil, to the point that your peers considered you overly optimistic. Do the facts support you?**

Albert Fishlow—I remain optimistic about Brazil, but there are a number of problems it must address. . . . The most serious problem at the moment is the lack of domestic savings, which is at about 17% or 18% of GDP. In today's world, to achieve an appropriate degree of development, a country needs at least 5 percentage points beyond that. Brazil is behind Chile, Argentina, and Mexico with regard to domestic resources for investment. In infrastructure, for example, there is much to do—the country will host a World Cup in two years and the Olympics in four. Besides infrastructure, there are needs in educa-

tion, health, and other public services that have not been met. Fortunately, Brazil now has a low birth rate, but a considerable portion of the population is aging, creating a future need for retirement resources. The country currently spends about 12% of GDP on pensions, and the situation will worsen. It is essential to address this problem so that the resources necessary for investments can be obtained to allow for higher economic growth.

What is your assessment of the administrations of Cardoso, Lula, and Rousseff?

As I mention in my book, Fernando Henrique Cardoso had the great merit of managing a transformation in the country's economic policy. No one could imagine a future for Brazil with those very high levels of inflation. At the same time, there was a favorable environment for adoption of laws to control budget deficits and maintain the primary surplus, which was very important. Lula brought to Brazil expansion of the social agenda. The Family Grant program consolidated the efforts made at the end of the Cardoso administration; today it represents about 0.5% of GDP, transferring resources to the poorest and improving income distribution. This clearly is a significant step. Rousseff's challenge now is to support these advances with sustainable fiscal, monetary, and social development policies. Fundamental changes are needed in public and private pension systems, as in Amendment 41 of the Constitution that regulates public employee pensions. We must reverse past practice: the government should save rather than just spend in order to allow adequate growth. Rousseff takes on a country with a slightly different profile. Besides manufacturing, the country now has a strong agricultural sector, which is an important source of exports and productivity increases. There is also the issue of oil, in particular deep sea oil, which will require much investment over the next few years. Oil resources at an enormous depth require cutting-edge technology and logistics to be exploited and transported. This is the opportunity of the new Brazil. Decisions taken now will determine the country's future. Major problems of the past have been resolved, but we must grow sustainably in coming decades—which means raising per capita income through increased productivity, not by raising the minimum wage.

One of the continuing problems is high interest rates. How do you see the Central Bank trying to change this situation?

Reducing the basic interest rate should be viewed as a process. In the 1990s real rates were much higher, above 25%

"We must reverse past practice: the government should save rather than just spend in order to allow adequate growth."

a year. They have been falling continuously, but with respect to the cycles, the changes occurring in the world. Continuity of this process depends on raising domestic savings. Despite growth and increased employment in recent years, the social security deficit is still about 3% of GDP. It is necessary to reduce that in order to transfer these resources to investment rather than consumption.

"I see future Brazilian foreign policy diversifing more within the hemisphere."

How can Brazil insulate itself from the global crisis?

It's very clear that Brazil . . . now has much less debt than it used to have, higher international reserves, and a healthier banking system than other countries. This is a great advantage in a world where there are Greece, Italy, Spain, and other ailing economies in Europe. Brazil is receiving huge amounts of foreign investment from around the world. I am optimistic when I compare the current situation with that of 25 years ago when the country's problems seemed insoluble. Today, the problems can be addressed. So instead of worrying so much about the day-to-day, Brazil should seize this window of opportunity to look further into the future. The country should maintain links within Latin America and explore better relations outside the region, not only with India, China, Russia, and South Africa, but also with Europe and the United States. For future development, a diversification strategy is the best option.

The world is having great difficulties in overcoming the crisis that began in 2008. What is your view about the standoff in the eurozone?

The euro is not going to disapear. What is needed is for the eurozone to adopt policies to encourage investment and make it possible to reduce unemployment, which remains extremely high in those countries. The problem of Greece is beginning to be resolved by the decision of private banks to accept a greater share of losses. In practice, we must recognize that it is impossible for Greece to continue having negative growth rates, year after year, with debt of 160% of GDP. The same goes for Italy and Spain. Germany should change trade relations with its neighbors by exporting less and absorbing more exports so the rest of Europe could benefit from Germany's better economic situation. But reversal of the situation must begin with the understanding that one cannot simply reduce and eliminate a fiscal deficit in a continuous and uninterrupted way. It is necessary first to adopt a more tolerant strategy until growth returns to major EU countries like Britain and France.

The U.S. economy registered signs of recovery early this year. But to what extent might the presidential elections constrain the recovery?

It seems clear that there are no great

expectations for the work of Congress this year in terms of legislation. But the U.S. economy has begun to post signs of recovery, with unemployment falling and real estate market activity increasing, though slowly. There is also evidence of investment and positive evidence in areas such as technology. This has enhanced the hopes for U.S. growth in 2012. One hears of a rate of 1.8%, and I believe it can be over 2%. If these estimates are confirmed, there will be a great stimulus to the rest of the world, where expectations are formed mainly by what happens in the United States, Japan, and Europe, which account for the largest share of international income. We know the importance of the BRICS and what Africa's growth represents, but we must recognize that the positive effects on the global economy will be much greater if the United States grows more than expected. President Obama knows the importance of this to his reelection campaign.

In this scenario, what is China's role?

It is very important, particularly because of its high growth rates. But we must not forget India, where 2012 growth is forecast at over 7%. These countries can have a favorable impact on the world economy, especially in Latin America, by increasing demand for agricultural inputs, oil, and metal commodities. Most of the growth in coming years will certainly occur within developing countries.

In Latin America Argentina has recently adopted protectionist measures against Brazil. Do you think that worsening of the external crisis would stimulate spread of this kind of protectionist measures? Is there a future for Mercosur?

Prospects have been better in the past. In the 1990s Mercosur was a basis for economic expansion for both Brazil and Argentina. But in the past decade, it lost importance, particularly for Brazil, which increased trade with other countries, in the region and outside. Argentina is no longer Brazil's main trading partner, falling to third place, behind China and the United States. ... Interest in closer ties, even a common currency, has greatly diminished. It is difficult to analyze the Argentine economy today because of problems with the quality of its reported data. Brazil, I think, is trying to establish closer trade relations with other countries in Latin America, hoping to benefit from above-average growth in Colombia and Chile, for example, to expand its exports. There is also the possibility of closer ties with Mexico, expanding markets for both industry

"I am optimistic when I compare the current situation with that of 25 years ago when the country's problems seemed insoluble. Today, the problems can be addressed."

and the financial sector. In this sense, I see future Brazilian foreign policy diversifing more within the hemisphere.

"In the 1990s Mercosur was a basis for economic expansion for both Brazil and Argentina. But in the past decade, it lost importance."

Despite Mercosur's difficulties, do you consider that Latin America may one day emerge as an economic bloc and increase its weight on the world stage?

Considering the current situation in Europe, the difficulties countries have had in forming the euro area and keeping the single currency, I see only with certain reservations Latin America forming a common economic bloc because there are vast differences between countries in the region. Manufacturing is much more sophisticated in Brazil than in Chile, Colombia, or Peru. And those three major economies have commercial interests in the Pacific; Mexico and Central America are more focused on the United States. So I am not sure this would be a good strategy for the region. Brazil, for example, already has a huge market, can use economies of scale in production of cars, and is well positioned to invest in research to advance development of proprietary technologies. Staying within the bloc and accepting higher tariff rates and less access to the world would be worse than seeking greater diversification. The new Brazil must face the world.



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Argentina raises new barriers to Brazilian imports

A new licensing law exacerbates the clash between the Kirchner administration and the country's main businesses, especially those that need imported parts for production. And Argentina's unpredictable policies are causing major losses for Brazilian exporters.



Marcia Carmo, *Buenos Aires*

Trade between Brazil and Argentina set a new record in 2011, reaching nearly US$40 billion. But 2012 began with great uncertainty for Argentine importers and Brazilian exporters. In January Cristina Kirchner's administration imposed new import licensing rules that could affect Argentina's imports from Brazil, its main trading partner. Much of Argentina's industry depends on inputs from Brazil.

According to Argentine economic analysts, the reason for the new rules is that the government hopes to reduce its trade deficit with Brazil and to increase its global trade surplus. Officially that trade deficit with Brazil is estimated to have been US$4.2 billion in 2011, but private analysis using official trade data put it above US$5 billion. "Argentina's deficit with Brazil is here to stay," says Mauricio Claveri, an economist with the Abeceb consultancy in Buenos Aires. "The government's measures in the area of imports will not solve the problem." The Institute for Social Development of Argentina (IDESA) issued a statement saying, "This new measure confirms that the government has a short-term policy, which ends up being harmful to the Argentine economy." The president of the Argentine Industrial Union (UIA), José Ignacio de Mendiguren, said the main problem for Argentine businesses is that import rules "depend on the mood of the officer on duty," not on what is written.

The new law, scheduled to take effect in February, says that Argentine importers have to make a sworn statement detailing what they are buying abroad. The request for an import permit is sent to the Federal Administration of Public Revenues (AFIP). But the final word will be given by controversial Interior Commerce Secretary Guillermo Moreno. Moreno is known for abrupt actions. A Petrobras director in Argentina, who requested anonymity, said, "He called me screaming to know what was going on with our business … . I have lived in many countries, but had not seen anything like it." Since that time, Moreno has acquired a variety of responsibilities, most recently for foreign trade under the Ministry of Foreign Affairs. "We depend on imports of [parts] … but they are stuck in customs for months, waiting for Moreno's decision," said one businessman, who also requested anonymity.

Miguel Ponce, who is general manager of the Chamber of Exporters of Argentina (CIRA), says some businesspeople prefer anonymity because they fear reprisals from the government. "We depend on imports to keep our industry operating.

"This new measure confirms that the government has a short-term policy, which ends up being harmful to the Argentine economy."

Institute for Social Development of Argentina

Some businesspeople prefer anonymity because they fear reprisals from the government.

We import, for example, almost 80 percent of parts of the cars we make. How do we make vehicles if imports are suspended?" he said. In turn, 80% of Argentina's vehicles are exported to Brazil. In December, before the new measure was announced, for example, Fiat reportedly suspended production of cars for a few hours because it lacked parts. And Ponce adds that there were already numerous brakes on imports: "We're still trying to solve previous problems with the government and now comes this new measure to complicate matters more."

A United Front

The new measure was announced in January during President Kirchner's

Argentina launches new import license

Solange Monteiro, *Rio de Janeiro*

The announcement by the Argentine government of the new import license — which covers all countries and products —fell like a bucket of cold water on many Brazilian exporters, who had found it hard enough in 2011 to get their products across the border. Sandro Jaenisch, partner in the Antunes and Machado Assessoria customs clearance company in Uruguaiana, Rio Grande do Sul state, says that low demand for its services so far this year reflects the expectation of how the licenses will affect exports. "Customers are on hold, searching for information about what actually will happen," he says. According to Jaenisch, whose business represents 180 Brazilian and Argentinean companies dealing with machinery, textiles, and footwear, the bureaucracy and the time it takes to release goods were already far from ideal in 2011: "In the vehicle sector, for example, while an Argentine product was released in 5 days to enter Brazil, [getting the Brazilian product cleared] took over 60."

The shoe industry was one of the sectors that suffered most. A survey by the Brazilian Association of Footwear Industries (Abicalçados) at the end of January found that 2.4 million pairs of shoes were waiting for clearance to enter Argentina, some shipments being more than 180 days late. "We have not had a discussion between the chambers of commerce on the new Argentine government licensing requirements, but we are very concerned," said an Abicalçados spokesman. Last year, the industry was already held back by a voluntary agreement to restrict shipments to 15 million pairs of shoes, compared with Brazil's export potential of 21 million. Argentina agreed that 5% of its shoe imports would come from Mercosur.

Brazil's production increased, "but we only managed to export 13 million pairs and there was no restraint on imports from Asian countries as agreed; at certain times the rate of imports from outside Mercosur exceeded 40%," Abicalçados stated.

For the industry, delayed clearance of goods means a significant loss, since the sale of shoes is directly related to fashion trends and seasons; sales peaks are often related to specific dates, such as Mother's Day (in October) and Christmas. "The importer loses much, because after investing in TV

leave for medical treatment. During her absence, Vice President Amado Boudou said disputes with Brazil were "natural" because bilateral trade had "multiplied" in recent years. When Kirchner returned on January 25, she announced that Argentina had recorded a major trade surplus in 2011: more than US$10 billion. But according to the INDEC, the trade surplus was 11% lower than in 2010 and 39% lower than the record US$16.8 billion in 2009.

Kirchner stressed that economic growth is a priority for her government. "The

"Without the screws required for each stage of production, our industry may suffer. If this measure is not well managed, we will not be hurting Brazil but ourselves."

Carlos Melconian

publicity and promotional campaigns the product does not reach the store," Abicalçados stated.

Robson Cardoso, commercial director of Jacto, a manufacturer of agricultural machinery, underscores highlights the impact. The company supplies 13% of the Argentine market for sprayers, but the import of spare parts is restricted. This is very difficult for the farmer "because that undermines the proper maintenance of his equipment," Cardoso says. After 60 years of his company serving the Argentine market, however, he is aware that selling to Argentina always implies ups and downs, like a roller coaster. "We passed through the devaluation of the peso, the change of an exchange rate peg to a floating exchange rate. We have suffered from the imbalance between the real and peso, and the effects of non-tariff barriers," he recalls, "so we know we should negotiate and seek an understanding." He notes that the Jacto subsidiary in Argentina is already in contact with local authorities to speed compliance with the new requirements.

Paulo Skaf, president of the Federation of Industries of São Paulo (Fiesp), advocates a similar path of negotiation. At a news conference in late January Skaf said Fiesp's technical team is studying alternatives to present to Argentine authorities. "For example, Argentina has idle capacity in the naval sector, while our shipyards are fully booked for the next 10 years. It would not be a sacrifice to ask Argentina to manufacture ships, considering them as a Brazilian product," he suggested, "in exchange for their taking better care of our issues, such as manufacturing exports."

Skaf is aware that the Kirchner government wants to ensure a trade surplus in 2012 that is about the same as 2011's US$11 billion because Argentina is having trouble getting dollars, but he warns the context is not favorable: there is high demand for energy imports due to drought on the one hand, and an expected drop in international prices of Argentine agricultural commodities on the other. "Meanwhile, in tune with the Brazilian government, we seek creative and friendly alternatives that penalize neither Brazilian exporters nor Argentine consumers," he says. "After all, shortages could lead to inflationary pressures that would also undermine the Argentine economy."

"The problem in Argentina is not the trade deficit with Brazil. The problem of Argentina is Argentina and its unpredictability. "

Marcelo Longobardi

economy grew 9% in the eleven months of 2011 and will continue to grow," she said. She did not refer directly to such controversial issues as the new licensing requirement and the official manipulation of inflation data. She did, however, praise the style of Secretary Moreno. She also defended AFIP Secretary Ricardo Echegaray, who also is often accused by Argentine businesses of acting in the government's political interests rather than following the tax law.

In an interview with Radio Mitre in Buenos Aires, Echegaray said he did not understand why Argentine importers are complaining: "They were asking for such a system, a single system, electronic data to focus and facilitate imports. And now that we have created the Affidavit Advance Import Declaration (DJAI), they complain. We do not want details like the color of the merchandise," he said. But when asked about the shortage of products in some sectors because of other barriers he replied: "The consumer has to complain to the company that is responsible for the shortage of the product. The companies are wrong. The government is doing its part."

What Economists Think

In an interview with *The Brazilian Economy*, Mariano Lamothe, another Abeceb economist, said the move itself seems simple, but the question is how it will be carried out. "If the 10-day period specified is observed, there will be no major problems for imports. But if this deadline is only a fiction, oh yes, we will worry very much," he said. For him "the big question" is whether the government will make this period a trade barrier for each item requested by an Argentine importer. "The expectation is that Moreno will call the importers asking for details before giving approval for imports. This will delay the application and the unloading of goods," he said. He expects Brazil to be one of the exporting countries most affected.

Importers, businesspeople, and economic analysts are virtually unanimous in stating that Argentine industry depends heavily on imports of basic materials. "Without the screws required for each stage of production, our industry may suffer. If this measure is not well managed, we will not be hurting Brazil but ourselves," said economist Carlos Melconian.

The move prompted similar criticism in the media. "The problem in Argentina is not the trade deficit with Brazil. The problem of Argentina is Argentina and its unpredictability," said Marcelo

Longobardi of Radio Diez, one of the most popular commentators in the country. "This measure will affect the government's most precious goal: industry growth and hence economic growth," said Thomas Bulat of the Buenos Aires financial daily *El Cronista*. According to official figures, Argentine industry grew 6.5% more last year than in 2010.

Besides taking care of the trade balance, Argentina wants primarily to protect its dollar reserves.

The Dollar Problem

Economists also noted that Argentina still has a trade deficit with Brazil even though the Brazilian real has appreciated more than the Argentine peso, showing that Brazilian industry is more competitive. They also understand that besides taking care of the trade balance, Argentina wants primarily to protect its dollar reserves. Lamothe explained that "All the measures taken in the last six months had the same goal: to stanch the bleeding of dollars. One imposed controls on the sale of foreign currency, for instance. Now [the government] wants to avoid an outflow of dollars to pay for imports."

Other analysts polled indicated that the Argentine economy is going through "a kind of creative adjustment" in order to avoid a fall in growth. President Kirchner calls this fine tuning. "Fine tuning because we are facing problems in each sector," she said. First there was the elimination of subsidies for public and private companies and the expected increase in consumer tariffs. Then there were the measures to contain runs on the dollar. Third, there were accusations against oil companies for fixing prices and a lack of investment—Kirchner claims that the companies were responsible for last year's energy deficit.

Alcadio Oña, a critic of Kirchner's management who is economic analyst for the *Clarin* newspaper, said the government wants to sustain the current exchange rate (about 4.3 pesos per dollar) "by force," through control of either sales of dollars or imports. "Basically what we lack is an industrial policy—or rather, long-term policies in general."

"Brazil's Foreign Ministry does not like our policy of trade integration"



Ricardo Lagos Weber

Chilean Senator, former trade negotiator and chief of staff

Solange Monteiro, Santiago, Chile

Chile has a paradoxical trade situation. At the same time as it demonstrates a unique dynamic in negotiating trade agreements around the world it also is heavily dependent on copper, which represents more than half its exports. For Senator Ricardo Lagos Weber, the son of former President Ricardo Lagos, however, the high international copper price overshadows the economic diversification that has given Chile access to international markets. "In times of crisis, when countries tend to close up, trade agreements protect us," said Lagos Weber, who speaks with the confidence of someone who helped negotiate agreements with the United States, Canada, and the European Union. Now a senator, he was previously chief of staff for President Michelle Bachelet. Lagos Weber also said that Mercosur is now "a complete failure" and Brazil has no interest in yielding sovereignty to a more institutionalized bloc.

***The Brazilian Economy*—Today Chile has 21 trade agreements with 58 countries, but the importance of copper exports to the Chilean economy does not seem to permit exploitation of the advantages these treaties offer. Is there a lack of initiative for more diversification?**

Ricardo Lagos Weber—Chile continues to be dependent on copper, with or without free trade agreements. But when you exclude it, there are other segments with export growth, such as salmon, fruit, and wine. Also, these agreements give us advantages, such as having a dispute settlement mechanism—something that is not true of Mercosur. Moreover, in times of crisis, when countries tend to close up, [trade] agreements protect us. This advantage declines over time as other nations sign their agreements, but today we have a distribution network that takes time to build up and will continue to be our advantage.

Chile also participates in Mercosur as an associate country. How do you evaluate this relationship?

It is no secret to anyone that Brazil's Foreign Ministry has never liked our policy of trade integration. In fact, the situation is precarious in Mercosur; regarding trade integration, in my view, the bloc does not exist. Mercosur has been a complete failure because, deep down, it has no interest to its members. But Chile cannot sit back hoping that someday Latin America will decide to negotiate seriously. I have focused on international trade and the only region that did not bother me was Latin America because there was nothing to do. We focused on Asia-Pacific, and it went well; I participated in trade negotiations with the United States and Europe, and I started negotiations with China and Japan, among others. These have brought us benefits.

Last April, Chile joined the Pacific Alliance along with Peru, Colombia ,and Mexico. What do you expect from formation of this bloc?

This alliance is related to a vision of development. The countries involved have opted for a strong trade integration system that the private sector and government are betting will open up. They calculate that, despite increased competition for their domestic products, they will profit from it. Colombia is organizing internally for this purpose. On the other hand, Mercosur does not believe in it—Argentina, because it lives in the past; Brazil, because of its tremendous domestic market. How much do exports matter to the Brazilian economy? 10% of GDP? Nothing. In Chile [exports] are near half of GDP. In Mexico, exports are also high, although it is a mono-exporter in terms of the destination market. Peru is going the same way, despite all its poverty and institutional weaknesses.

Mercosur in this case is an example of how not to do a trade agreement?

My concern is that Mercosur lacks institutions. Look at the European Union. There are large countries with great influence, such as Germany. But the decision-making must involve everyone. Not all nations have the same weight, because there is a weighting based on population and economic size, but the Netherlands, Belgium, and Portugal, for example, can come together and ensure their weight. In Mercosur, look at what happened in the pulp mills dispute between Uruguay and Argentina. Argentina put the rule of law in its pocket and Brazil fell silent. If there is no institutional framework, anything can be imposed on small countries, because there isn't a collective goal.

Do you run the same risk with Mexico, which is the largest economy of the alliance?

Mexico is willing to accept rules that give the minority stakeholder the right to be heard.

Is it not a risk to make such a broad agreement—which includes movement of people—with Peru, a country with which Chile has a dispute over maritime boundaries?

This is a very sensitive subject. Here I see a situation that is trying to get resolved. But I think Peru sent a negative signal in wanting to question existing treaties. That really caused a setback in our relationship, but so far it has not contaminated the economic relationship. In fact, Chile is investing more in Peru, and Peru is investing in construction and retail in Chile. I am confident that we will do well in The Hague. The question that remains is how Peru will react to an adverse decision.

Could a possible success of the Pacific Alliance generate comparisons with Mercosur and challenge its members to review their agreement?

Maybe. Actually, I am hopeful that we will converge in the future. Brazil has weight, and therefore must exert leadership. But [countries] must surrender sovereignty only to a system that has institutions and mechanisms for dispute settlement, which would allow me to sit tranquil at a negotiating table with Brazil.

"Mercosur has been a complete failure because, deep down, it has no interest to its members."

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