

THE BRAZILIAN ECONOMY

FGV
Economy, politics and policy issues • MARCH 2012 • vol. 4 • nº 3
A publication of the Getulio Vargas Foundation

IBRE Economic Outlook
Brazilian economy is expected to grow about 3% in 2012 but major risks still cloud the horizon.

Industry
Will Brazilian industry do better in 2012?

Latin America
Peru's unfinished work

HEALTH
Can we build a new health system?

Almost two-thirds of Brazilians consider the health system poor or very poor. Yet Brazil spends more than many countries that have better results.

Interview
Dr. Adib Jatene: Health care needs less criticism, more resources.

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The BRAZILIAN ECONOMY

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Economy, politics, and policy issues

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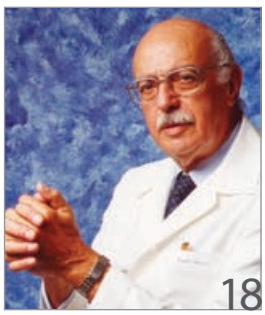








Photo: Wikimedia Common.

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Brazil wants to renegotiate its trade agreement with Mexico. Argentina puts up roadblocks to imports from Brazil. All are members of regional and subregional trade groups, but economic integration is barely a shadow on the horizon. João Augusto de Castro Neves explains why it will not get any closer without broad reforms to increase competitiveness and constant political coordination by the leading economies.

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Almost two-thirds of Brazilians consider the health system poor or very poor. Yet Brazil spends more than many countries that have better results. Kalinka Iaquinto asks a number of experts questions like whether Brazil invests too little in health or whether the resources going into the system are badly managed and solicits their opinions on what needs to be done. Thais Thimoteo describes an effective municipal system, and Solange Monteiro explains where private plans fit in.

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Two-time Health Minister Adib Jatene now practices as a cardiac surgeon and Heart Hospital director. He gives Kalinka Iaquinto his assessment of Brazil's public health system, how it is funded, and what is needed to better serve disadvantaged Brazilians. Dr. Jatene points to Brazil's status as a world leader in prevention services and its Family Health teams as positive signs of progress.

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Brazilian industry is suffering from a combination of such factors as the global crisis, unfavorable exchange rates, and intensified competition from imports. Wages are growing, but productivity is not. Claudio Accioli analyzes industry's competitive problems and explains why in the long term predictions for industrial production become explicitly pessimistic.

LATIN AMERICA

28 Peru's unfinished work

Sensing stability in the economy, expatriate Peruvians are coming back home. Over the past decade, average growth in Peru has exceeded 6%, and poverty fell from 50% of the population to 31%. The new president is committed to maintaining economic discipline. Local experts explain to Solange Monteiro why structural reforms to ensure that government is more efficient and transparent and that the private sector is profitable are critical to Peru's economic growth.

IBRE MARCH ECONOMIC OUTLOOK

33 In 2012 the Brazilian economy is now expected to grow about 3% and inflation to decline to 5.2%, with the benchmark interest rate ending the year at 9%. Major risks to the outlook are European financial uncertainties and stagnation in domestic manufacturing.

ECONOMY

Opening a business not easy in Brazil

Although the time it takes to open a company in Brazil has dropped 20% since 2007, at 119 days it is still one of the longest in the world, says the World Bank. Not only does Brazil come in at 179th in the global ranking of 183 countries, it is far outstripped by other major emerging countries: in India it takes 29 days, in Russia 30, in China 38, and in South Africa 19 days. Brazil demands 13 legal procedures, Canada and New Zealand just 1. (February 15)

Current account deficit widens

Brazil's current account deficit rose from US$6 billion in December to US$7.1 billion in January. The trade deficit (US$1.3 billion) for the month was the worst since 1998, though it was offset by foreign direct investment (US$5.4 billion) and portfolio inflows, mostly into equities after the government lifted the tax on foreign investment in stocks last December. However, international reserves increased to US$355 billion. (February 23)

A disappointing 2011

Brazil's economy grew just 2.7% in 2011, although early March data suggest that this year growth is accelerating somewhat. Recent data from the government statistics agency, IBGE, show that agriculture and domestic demand began to stimulate growth in the final quarter of 2011, although industry shrank 0.5% compared to the third quarter. (March 6)

Industrial output fell in January

Output at Brazil's mines and factories in January was far worse than expected; widespread decline was exacerbated by a slump in production of trucks and lost iron mining due to heavy rains. Industrial production in January fell 2.1% from December, the worst decline since 2008; it quashed a brief two-month revival in output, according to IBGE. (March 7)

Inflation slowed in February

Inflation in Brazil eased in February to its slowest pace for that month in five years. Brazil's official consumer price index rose 0.45 percent in February, IBGE said. Consumer prices rose 5.8 percent in the 12 months through February. (March 9)

LATIN AMERICA

Latin America dependent on commodities and China

Latin America's "growing dependency on commodities and China requires improving lines of defense against sharp and sustained terms of trade losses," the Institute for International Finance (IIF) said in its latest regional overview. The IIF also said that the region's economic improvement relative to developed economies suggests that "appreciation pressures on local currencies are to some extent warranted." Countries must therefore improve productivity and reduce government deficits "to widen the scope for interest-rate cuts," the IIF said. (March 8)

JUDICIARY

Clean Record Law validated

On February 16, the Supreme Court ruled 7–4 that the Clean Record Law is constitutional. The 2010 law bars sentenced politicians from being elected for eight years. The law is a popular initiative presented to Congress after being signed by more than 1.3 million voters. (February 16)

POLITICS



Photo: Valter Campanato/ABr.

Former candidate to the presidency and governor of São Paulo José Serra.

Retired military charged with insubordination

The government ordered military commanders to punish with a warning for insubordination retired military who on February 28 issued a letter attacking President Rousseff and Defense Minister Celso Amorim. The letter criticized the president for not disavowing statements by ministers and the Workers' Party favoring investigation of events during the military regime (1964–1985). (March 1)

José Serra returns

After months denying any such interest, former mayor of São Paulo and presidential candidate José Serra (Brazil's Social Democratic Party, PSDB) on February 27th announced he will again seek his party's nomination for mayor. São Paulo, Brazil's biggest municipality with 11 million residents, is Brazil's business center. Its mayor matters. The result of this election will also affect the future of the PSDB, which is the main national opposition to President Rousseff. It also has implications for the governing Workers' Party (PT) and the 2014 presidential election.

FOREIGN POLICY

Germany endorses EU/Mercosur agreement

Brazilian Foreign Minister Antonio Patriota and his visiting German counterpart, Guido Westerwelle, have called for a free trade agreement between the European Union and South American trade bloc Mercosur. "We count on the Brazilian presidency [of Mercosur] in the second half of the year" to make progress, Westerwelle said. Negotiations have stumbled over differences on agriculture—notably Europe's subsidies to its farmers. Reaching a deal "will not be easy," but Westerwelle said Berlin would use "all its weight to ensure that the negotiations succeed." (February 15)



Photo: Fabio Pozzebom/ABr.

Foreign Ministers Guido Westerwelle of Germany (left) and Antonio Patriota of Brazil.

Brazil pushes for non-American World Bank president

Brazil urged the World Bank to consider developing-country candidates to replace outgoing president Robert Zoellick. "There is no reason for the president of the World Bank to be a specific nationality. It should just be someone competent and capable," Finance Minister Guido Mantega said, pushing for an end to a 65-year tradition. "Our goal is that emerging countries have the same chance to compete to lead multilateral organizations," he said. Zoellick's five-year term ends in late June, setting up a possible fight over U.S. dominance at the Bank. (February 15)

ECONOMIC POLICY

Fund for civil servants created

By 318–134 the House passed a bill creating a complementary pension fund for federal civil servants that is more closely aligned to the private pension scheme. The maximum Social Security pension benefit is R$3,916 and the tax is 11% of salary. A civil servant desiring a larger benefit must now contribute to a supplementary fund. (February 28)

Primary budget surplus sets record in January

Brazil posted a record primary budget surplus in January—the latest evidence that President Rousseff's push for fiscal restraint is helping pave the way for lower interest rates. The consolidated surplus was R$26 billion (US$15.3 billion). In the 12 months through January, the primary surplus, which excludes debt-servicing costs, was equivalent to 3.30% of GDP, up from 3.11% in December. Brazil plans to freeze R$55 billion ($32 billion) in spending this year to help meet its 2012 primary budget surplus target of R$139 billion. Brazil's debt-to-GDP ratio edged up to 37.2% in January from 36.5% in December, the central bank said. (February 29)

Central bank slashes rates

A larger-than-expected cut of 75 basis points has pushed the central bank benchmark rate down to 9.75%; the cut was supported by five voting policymakers; two others voted for 50 bps. Disappointing GDP figures for Q4 2011, slowing industrial production in January, and low inflation in February may have tipped the balance in favor of the larger reduction. (March 8)

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April 2011

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How fit is Brazil's health system?

In 1988 the Brazilian constitution set out comprehensive health spending rules. They never quite made it into practice. Now Amendment 29—discussed for over a decade—touches on management and specifies some health-related spending. It may take some time before that gets realized as well.

Brazil often leads the world in prevention activities. We have the largest percentage of people vaccinated; our approach to AIDS prevention is a model. We have some excellent public tertiary care hospitals. But primary care does not work well. And how can we have a healthy economy if we don't have healthy workers?

Health networks organized by region and coordinated centrally have been shown to increase the efficiency and quality of health services. A state capital in Brazil, Florianópolis, Santa Catarina state, and a regional neighbor, Mexico, offer lessons in how they work:

Brazil often leads the world in prevention activities . . . But primary care does not work well.

Having decided in 2006 to make primary health care a priority, Florianópolis now has about 110 networked family health teams that serve 90% of the population. Hospital admissions have fallen by 28%, especially for life-style diseases the teams can treat and for pregnancy problems—pregnant women now average 7 prenatal visits. Dental problems have declined by 67%. But Jorge Zepeda, Florianópolis Health Department manager of primary care, points out that "the largest share of transfers from the federal government is going to hospitals for high complexity health care . . . What little is left goes to primary care." Florianópolis spends 21% of its budget on health care, far more than the mandated 15%.

In Mexico a 1980s amendment made health care a constitutional right, "but we didn't have it in practice," David Garcia-Junco Machado, Mexico's national commissioner for social protection in health recently told an interviewer.[1] Since the 1940s the public Mexican Institute for Social Security has insured salaried workers. Left out were not only the very poor but also farmers, odd-job laborers, self-employed professionals—anyone without a formal salary. In 2003 the federal government launched Seguro Popular to fill the gap. Now 52 million Mexicans are enrolled—many had never before had even a checkup. They are covered for a wide range of basic medical services and at least 80% for catastrophic illnesses (100% for children up to 5). All but the poorest pay something based on a percentage of their income. Other funding comes mainly from federal and state tax revenues. Since 2005 the Mexican government has built more than 4,000 hospitals, clinics, and mobile medical. Seguro Popular does have some problems: in the poorest states, medical care can be uneven and waiting times long. Because the two previous systems are still in place, there's some fragmentation.

In the interview in this issue former Health Minister Adib Jatene discusses budget and other problems the Brazil public health system must deal with. But as the articles make clear, a major problem for Brazil may just be short-term thinking, and perhaps some reluctance to act on the commitments made in the law.

[1] University of Chicago Magazine, Mar-Apr 2012, pp. 27–28.

To trade or not to trade

Despite a laundry list of regional and subregional institutions, so far economic integration is at best only a tentative reality in Latin America. Trade agreements are vulnerable to a multitude of competing interests and the unpredictable ebb and flow of international trade.

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

The Brazilian government announced last month that it would seek to renegotiate the automotive trade deal with Mexico. The decision has caused concerns that it may represent a shift toward a more protectionist stance, especially considering last year's decision to raise taxes on imported cars and auto production for automakers that do not meet a 65% local content requirement.

The main reason for the decision to review the trade deal with Mexico is that since the last review of the accord in 2009, bilateral trade flows have become significantly unfavorable to Brazil. From the time the automotive deal was signed in 2002 until the 2009 renegotiation Brazil had sustained trade surpluses with Mexico. Since then, Brazil has logged consistent deficits with Mexico—they reached $1.2 billion in 2011. Automobiles and auto parts account for about 45% of Brazil's total imports from Mexico.

For Brazil, two issues stand out. First is the local and regional content requirement of cars imported from Mexico. The floor today is 35%, but Brazilian officials want to apply at least the 45% level that is required from the Mercosur bloc (Mercosur countries and Mexico are exempt from the 65% requirement on auto imports from the rest of the world). The second issue is that Brazil wants to bring trucks and SUVs into the deal. If Mexico accepts the expanded coverage, in theory that might make trade flows more balanced, or even tip the automotive trade balance slightly in Brazil's favor.

The noise the renegotiation has generated may be a result of the timing of the announcement: Last September the Brazilian government increased the tax on auto imports for companies that did not meet a 65% local content requirement. With this as background, the renegotiation with Mexico might be seen as one more surge of

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a protectionist wave. Faced with increasing pressure from importers and potential investors, however, the government had to profess that the intention behind the measure was to stimulate local auto supply industries, not discourage foreign investors. In fact, Brazil recently issued a list of 18 automakers that will be exempt from the tax hike.

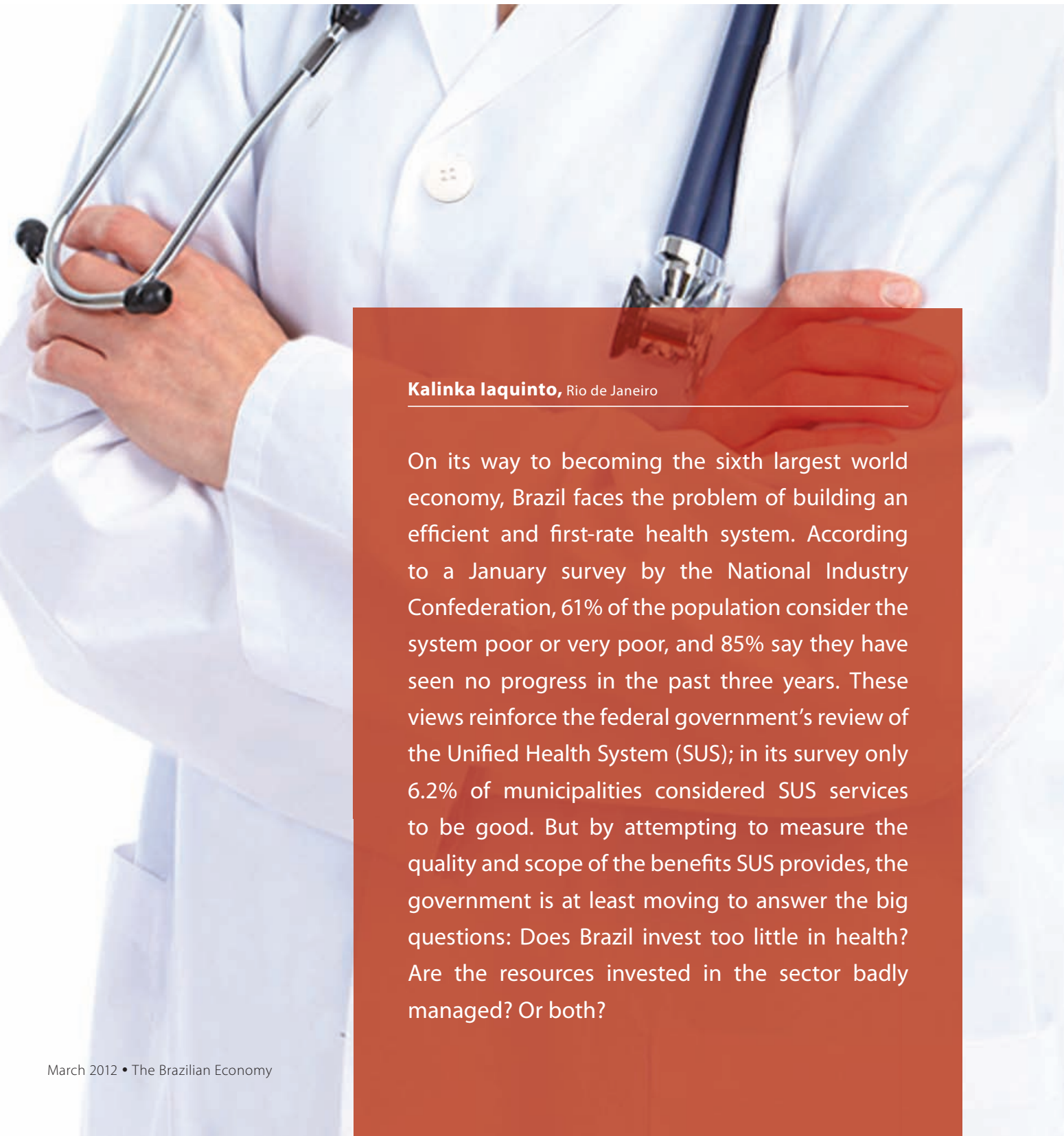
These measures, however, are unlikely to be extended arbitrarily to other sectors—that would definitely represent a more protectionist shift in trade policy. Rather, any new measures will likely target specific sectors and be driven by concerns about specific industries. For example, there has been mounting pressure from the local textile industry and the capital goods sector, both of which have been affected by growing imports. Moreover, the government will probably have to take a pragmatic line because it must balance the desire to protect sectors with attracting foreign investment and maintaining good relations with trading partners.

Nevertheless, Brazil's recent decision to review its deal with Mexico highlights the distance between the harsher constraints on local industries and the country's ambitious rhetoric about economic integration. High taxes and labor costs and the well-known infrastructure bottlenecks greatly reduce the competitiveness of Brazilian companies as imports from Asia keep growing. The problem does not affect just Brazil's relations with Mexico. Seeking to raise revenues while protecting its local industry, Argentina recently implemented a set of restrictions on its trading partners; and the main one affected is Brazil. Clearly, trade agreements between the largest economies in the region are vulnerable to a multitude of competing interests and the unpredictable ebbs and flows of international trade.

There has been mounting pressure from the local textile industry and the capital goods sector, both of which have been affected by growing imports.

Despite a laundry list of regional and subregional institutions and agreements, economic integration in Latin America is at best still only a tentative reality. And without broad economic reforms to increase competitiveness and constant political coordination by the leading economies, economic integration in the region is unlikely to move beyond the tentative.

Can we build a new health system?



Kalinka Iaquinto, Rio de Janeiro

On its way to becoming the sixth largest world economy, Brazil faces the problem of building an efficient and first-rate health system. According to a January survey by the National Industry Confederation, 61% of the population consider the system poor or very poor, and 85% say they have seen no progress in the past three years. These views reinforce the federal government's review of the Unified Health System (SUS); in its survey only 6.2% of municipalities considered SUS services to be good. But by attempting to measure the quality and scope of the benefits SUS provides, the government is at least moving to answer the big questions: Does Brazil invest too little in health? Are the resources invested in the sector badly managed? Or both?

In truth it is not easy to bring full and fair universal health care to 190 million people, of whom 145 million depend exclusively on the public system, where a lack of basic services coexists with advanced programs that meet international standards. But despite failures and inefficiencies, there seems to be a consensus that addressing funding and management issues could help solve national health problems.

According to a January survey by the National Industry Confederation, 61% of the population consider the system poor or very poor, and 85% said they saw no progress in the past three years.

Room to improve

"In terms of health, Brazil spends more than many countries that have better results, which means we could improve our performance with current spending," says Bernard Couttolenc, a health economist who is CEO of Performa Institute. Despite cuts, the Ministry of Health is getting the largest share of the 2012 federal budget: R$72 billion—up from R$23 billion as recently as 2000. When private spending is added to public, Brazil currently spends about 8% of GDP on health. However, contrary to most developed countries, the state spends less than the private sector.

Recent data from IBGE (the Brazilian Institute of Geography and Statistics) shows that in 2009 households spent 29.5% more on health-related goods and services (R$157 billion—R$835 per capita) than the government (R$124 billion—R$645 per capita). "This larger private sector share in health spending in Brazil has been the case for a long time," says Ricardo Moraes, IBGE manager of national accounts. Data from the World Health Organization (WHO) classified Brazil 72nd among 193 countries in terms of per capita expenditure in health, behind neighboring Argentina, Uruguay and Chile, whose economies are much smaller. Brazil's performance, according to the WHO, is 40% lower than the international average.

Moraes does point out that since 2000 government spending on health has increased more significantly than household spending. According to Gabriel Leal de Barros, a researcher for the Brazilian Institute of Economics of Getulio Vargas Foundation (IBRE-FGV), this is not just a matter of political will. The Constitution of 1988 set out more comprehensive health spending rules. He also pointed out that Ministry of Health budget execution has improved from 80% in 2007 to 87% last year.

Ligia Bahia, professor, Institute of Public Health, and coordinator, Laboratory of Political Economy of Health, Federal University of Rio de Janeiro (UFRJ), believes that for Brazil to actually achieve universal health care, "It is [necessary] not only to contribute more money, but to abolish public subsidies for private spending on health. Tensions on

"Brazil spends more than many countries that have better results, which means we could improve our performance with current spending."

Bernard Couttolenc

the prioritization of health spending in the government agenda will continue. In 2012 health sector issues will be priorities for mayors and city councils." Fausto Pereira dos Santos, advisor to Health Minister Alexandre Padilha, admits that "Those who work in the health sector recognize that funding to the health sector is not enough compared with countries in South America or those with universal systems."

Constitutional standards

Amendment 29 of the Constitution sets out minimum annual spending on health by the federal government, states, and municipalities. After 11 years of discussions in Congress, last January the amendment became a complementary law (141/2012) that was signed by President Rousseff. Yet there has been no substantial change with respect to the share of public spending on health. The law requires that states allocate 12% of revenues to health, municipalities 15%, and the federal government the same value as in the previous year plus at least the nominal growth of GDP in the previous two years.

Politicians, managers, doctors, and health sector workers have advocated that the federal government spend 10% of revenues on health. However, the government argues that constant changes in the amounts allocated to health could lead to budget and fiscal instability. "In our assessment, what was approved was far short of what Brazil needs," Aloísio Tibiriçá Miranda, vice president, Federal Council of Medicine (CFM), complains. The financial discussion was too short-term, says Alexandre Marinho, researcher, Institute of Applied Economic Research (IPEA) and adjunct professor at the State University of Rio de Janeiro (UERJ). The discussion turned on "how many



billions more or less we can afford today," he points out, but "No one asks how this model will be in five, 10 or 20 years. What are the alternatives if the resources mandated are not sufficient?" Miranda recalls that before Congress voted, the health minister himself had insisted that the sector would need an additional R$45 billion in investment, but "The bill passed in the Senate would provide [only] R$35 billion."

De Barros, however, thinks the possibility of the federal government spending 10% of revenues on health is not feasible. He warns that "The government would have no way to reconcile this figure with adequate funding in areas such as education and social security."

The expectation is that the new law will provide some qualitative improvements. "Amendment 29 touches on management when specifying health-related expenditures," de Barros says. Dr. Bahia adds that this requirement can enhance transparency and control of health budgets, saying "Governors and mayors have mishandled resources by including other expenditures in health accounts." Paulo Ziulkoski, president, National Confederation of Municipalities, disagrees: "The municipalities had to allocate 15% to health, but the national average has been 22%. In the last 11 years, municipalities have already put in R$130 billion more than the mandatory 15%."

Couttolenc believes that "Our system is very wasteful and inefficient. Despite some significant improvements in the SUS, through programs like Family Health (Saúde da Família) and Primary Care (Atenção Básica), there are still major distortions in resource allocation, management, and financing that, if corrected, would greatly reduce the need for additional resources."

By attempting to measure the quality and scope of the benefits SUS provides, the government is at least moving to answer the big questions.

IBRE's De Barros agrees. He notes that reports from the Court of Audit and the Comptroller General show clear weaknesses in efficient government management of resources. "The ability to monitor and control the Ministry of Health is very limited," he observes. "Management basics, such as monitoring executed and budgeted expenses, are disregarded."

IPEA's Marinho approves of investing directly in management. "It is important to hire workers, review working arrangements, and invest in specific knowledge in managerial techniques to guide health agencies. These important steps have been adopted by health sectors in other countries, but not in Brazil," he says. The decentralized SUS structure—the federal government formulates national policies to be carried out by states and municipalities—hinders progress because not all local units have the resources and qualified personnel to manage the sector.

"Tensions on the prioritization of health spending in the government agenda will continue. In 2012 health sector issues will be priorities for mayors and city councils."

Ligia Bahia



Photo: Valter Campanato/ABr.

Can it be done?

An IPEA study[1] reveals that Brazil invests almost as much in the health sector as the countries of the Organization for Economic Cooperation and Development (OECD), which should warrant better results. Investing efficiently in health, Marinho says, "would have a very high return for society [such as reduced mortality and life expectancy at birth], possibly even better than in some OECD countries." The OECD study suggests that Brazil has the ability to convert resources into action, but in Marinho's view resources are still insufficient and better administration is noticeably lacking.

To fulfill the constitutional mandate of universal health care for all Brazilians seems an almost impossible task. International studies point to investment in health networks organized by region and coordinated centrally as a way to increase the efficiency and quality of health services. Couttolenc agrees but says, "The SUS has made sparse and timid actions in this direction, and almost nothing has been done in the private sector. Expanding and building up this strategy should be a priority to improve our health care system."

Couttolenc also recommends that the public and private sectors move quickly to join efforts to improve the financing and management of the health system because they face three major challenges: rapid aging of the population; increasing expectations of society regarding the quality and humanization of health care; and the need to eliminate the current division between SUS and the private sector to get rid of duplication and inefficiencies. He says, "We need a clear design with roles and responsibilities defined and mechanisms for coordination."

[1] Alexandre Marinho, Simone de Souza Cardoso, e Vivian Vicente de Almeida, "Brasil e OCDE: Avaliação da eficiência em sistemas de saúde," Instituto de Pesquisa Economica Aplicada, Rio de Janeiro, 2009, http://www.ipea.gov.br/portal/index.php?option=com_content&view=article&id=4922&Itemid=2.

Florianópolis city: A healthy example

Thais Thimoteo

Ranked in the top five in the federal government assessment of the national health system, Florianópolis, capital of Santa Catarina state, stands out among cities because it has better access to and a higher quality of public services. This results from a 2006 policy shift related to primary health care.

Currently, about 110 networked family health teams serve 90% of the population, which the Health Department of the City of Florianópolis says is the greatest coverage among state capitals. To ensure that performance, Jorge Zepeda, Health Department manager of primary care, explains that despite advances, it was necessary to confront some problems, one of them being resistance to the program among the people. "In the primary health care model, the first step is for patients to consult with a general practitioner. But this was rejected by people familiar with the old model of health, in which they would often visit the specialist without first consulting a physician. In fact, this custom harms the person, because a specialist doctor is not always aware of the history of the patient and may recommend treatment and expenses that may not be necessary."



Photo: Divulgação SMS Florianópolis.

Despite difficulties in implementing the new primary health care model, the results are already showing up in health indicators. From 2006 to 2011, the infant mortality rate in Florianópolis for children under 1 year fell from 9.1 to 8.4 per 1,000 live births. Also, between 2008 and 2011 hospital admissions declined by about 28%. The declines are particularly noticeable in terms of diseases treated by primary care teams (hypertension, obesity, diabetes, etc.) and the increase in doctor visits by pregnant women (74% of them were seen 7 or more times). The number of dental problems also declined by 67% between 2003 and 2008, and primary care units hired 495% more medical and nursing students. "We adopted a system of teams in which about 90% of the professionals are public employees. This reduces staff turnover and gives staff more experience and knowledge of patients' history, increasing the capacity and efficiency of health care services," Zepeda said.

To sustain those services Florianópolis last year spent 21% of the city budget on health compared to the 15% mandated by law. "The funds received from the Ministry of Health and the government of Santa Catarina state are not sufficient to cover even one-third of what is spent on primary care," says Daniel Moutinho, Florianópolis director of primary care. Zepeda reports that it takes "more money to keep teams. Today, the largest share of transfers from the federal government is going to hospitals for high complexity health care, which has high political visibility and influence from the pharmaceutical industry. What little is left goes to primary care."

Where private **plans fit in**



Solange Monteiro, Rio de Janeiro

When a public service does not meet expectations and there is money to invest, an immediate solution is to pay for a private alternative. In Brazil, increased incomes have been reflected most obviously in sales of cars and more demand for private education, but growth in formal employment has also brought about an increase in collective health insurance plans subsidized by companies. Yet although they are on the wish lists of many Brazilians, according to a study by the Institute of Applied Economic Research (IPEA), health insurance plans are still considered expensive, even if they provide better services.

Growth in formal employment has also brought about an increase in collective health insurance plans subsidized by companies.

More complex and expensive technologies to perform diagnostics, a lack of rationality in their use, and stricter regulation—Law 9656 of 1998 and supervision by the National Health Agency (ANS) since 2000—are among the factors market participants mentioned to justify the high price of the plans. Marcio Coriolano, president, National Federation of Private Health Insurance (FENASAÚDE), argues that "We cannot offer the flexibility to give the consumer the option to choose the protection he wants according to his pocket [when] increases in medical costs exceed general inflation in the economy."

Of the 47 million users of private health plans in 2011 in Brazil, 77% were in group plans. This implies two realities: beneficiaries and their families depend on continuing employment for health

insurance coverage, and once they retire, they may not be able to afford a plan to help cover health expenses.

Adversity

"The rules of the market and an aging population start to determine very adverse contracts and price structure," says Mônica Viegas Andrade, coordinator, Study Group on Health Economics and Crime, Department of Economics, Federal University of Minas Gerais. "And the fact is that although the public system provides medical centers of high quality and complexity, elective and outpatient care does not work well. Overlaps of public and private health care services reflect inequalities in income, ensuring access only to the ones that can pay," she says. Paulo Hirai, director, SantéCorp consulting, notes that paying for a health plan can be 10 times more expensive for the elderly than for someone 25 years old, "and we are aging rapidly."

"We're talking about the market. There is no charity," Coriolano says. "What we can do is offer alternatives." FENASAÚDE, along with others, has sent a proposal to ANS for a product like a supplementary pension plan that could improve the funding to cover the population. "It's a model like health saving accounts in the United States," he says. "The ANS and the Private Insurance Agency (Susep) have been studying this model for two years. We hope it will be adopted this year, with enough of a tax exemption to allow a capital gain."

FENASAÚDE, along with others, has sent a proposal to ANS for a product like a supplementary pension plan that could improve the funding to cover the population.

Hirai explains that in this system, the beneficiary pays health expenses up to a maximum limit; above it, the plan pays. "The advantage is that if the health expenses limit is not used, it will be available to finance the health costs of the beneficiary in old age." Hirai believes this model could provide a benefit to the health system as a whole: "For companies, it will require more competitive management models, with more balanced choices about diagnoses, treatments, and surgery," he says. As an illustration, he notes that the U.S. government estimates that health spending—totaling US $2.7 trillion a year—could be a third less if services were better managed. Hirai adds that "It would encourage consumers to opt for a healthier standard of living, because they would also have to pay for services used." He notes that more than 70% of the spending plans cover the care of chronic diseases, such as hypertension, heart disease, and diabetes, which are affected by a patient's lifestyle.

The big health need: Less criticism, more resources

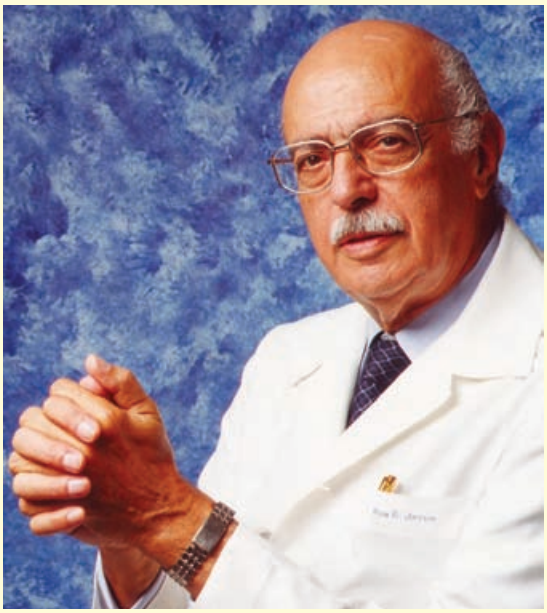


Photo: Divulgação.

Adib Jatene

M.D., former Health Minister

Kalinka Iaquinto, Rio de Janeiro

Health Minister under both Fernando Collor and Fernando Henrique Cardoso, today Adib Jatene is in private practice as a cardiac surgeon and is director of the Heart Hospital of São Paulo, although his advice still continues to be widely sought. Dr. Jatene warns that to improve the quality of its public health, Brazil needs to at least double the resources allocated to the health care sector. He cites as positive the strategy that helped establish the Family Health program but warns, "Instead of just criticizing and demanding, we need to help solve problems."

***The Brazilian Economy*—What is your assessment of Brazil's public health system?**

Adib Jatene—Until 1990 public health work was funded with Social Security resources. When Social Security stopped funding health care in 1993, it was a big financial blow. The government sought to create special taxes to finance the health budget . . . The federal government paid 60% of health costs and states and municipalities 40%. In 1996, when I was health minister in the Fernando Henrique Cardoso administration, we created the CPMF (Provisional Contribution on Financial Transactions). Unfortunately, the government withdrew from it the resources of the Ministry of Health, and financing remained much lower than the 1988 Constitution intended.

What will change when the 29th Amendment is passed?

The 29th Amendment will transfer to states and municipalities a large part of the responsibility for financing the

health system. Spending on health rose from 2.9% of GDP in 2000 to 3.6% in 2008. The federal government reduced its participation from 60% in 2000 to just over 40% today, while states and municipalities have increased theirs to nearly 60%.

How will this affect the health system?

The federal government collects about 60% of national taxes and states and municipalities collect 40%. Yet the federal government's contribution to the health system has decreased and state and municipalities increased. This creates a problem for the system. All hospitals that provide care exclusively to patients of the Unified Health System (SUS) are virtually bankrupt. In Rio de Janeiro and São Paulo, the big hospitals today are those that do not treat SUS patients.

What are the alternatives to get resources?

In last year's budget, total spending was nearly R$ 2 trillion, of which 53% was interest on public debt. That leaves only 47% for the government. Of that, about R$160 billion goes to the States and Municipalities Fund, which cannot be touched. Another R$170 billion pays public employee wages and benefits. About R$350 billion goes to Social Security. That leaves nearly R$200 billion for 38 ministries, of which 30% goes to the Ministry of Health. It is very difficult to find resources within the budget to cover Brazil's health system needs.

Brazil has grown very fast. For example, in 1890, France had 33 million inhabitants and today it has 63 million —the population did not even double. In 1890 the city of São Paulo had 45,000 inhabitants and today it has 11 million. Our development has taken place in a relatively short time. So it is impossible to cover all needs with domestic savings . . . We [had to turn to] loans, and interest on these loans is eating up 53% of our budget.

People are not satisfied. Are there prospects for improvement in the health sector?

Unfortunately, the government has not the money to invest in the sector. Gradually ... tax collection will improve and tax evasion will decrease. We will be able in the medium term to obtain the resources. [But] now we cannot offer the population all the technology available. That is impossible, nobody can.

What sectors within the health system deserve more attention?

In the prevention area Brazil is ahead of many countries, even the most advanced. We are the country that has the most people vaccinated and we are eliminating all vaccine-preventable diseases. We created a program for treatment of AIDS

All hospitals that provide care exclusively to patients of the Unified Health System (SUS) are virtually bankrupt.

that is a world model, well regarded by the World Health Organization. The Family Health program is also a model prevention program: in each core of 100 to 200 families, one resident is appointed as community health agent who enrolls families in the program, checks for pre-existing conditions, maintains immunization records, and ensures that pregnant women are doing prenatal follow up. We now have about 30,000 family health teams. We need to double the number, but we do not have the resources. Nevertheless, we are making progress. In all areas where they are working, the health situation has improved.

In the prevention area Brazil is ahead of many countries, even the most advanced. We are the country that has the most people vaccinated and we are eliminating all vaccine-preventable diseases.

If there has been progress, why are there are so many complaints?

One person takes six months for an exam, another sits in the queue for a long time, and that is what draws attention. The fix for this is very complicated because . . . the technology in the health area is very expensive. It is very difficult to mobilize all the equipment needed to serve the entire population. The intention is perfect, the areas that have the Family Health program are very satisfied, but still some people are not yet receiving care and therefore they are not satisfied.

Do you believe that besides the lack of resources there is also mismanagement in the health sector?

The idea that we spent badly and that the problem is resource management is a hasty analysis by those not familiar with the health system. The system that wastes more resources with unnecessary tests is the private sector, not the public . . . Administrators in the public sector work with very limited resources, and they are very good. Here in São Paulo the two largest hospitals have hired administrators from the public sector.

Different social and economic realities are barriers to progress in health care. How can we serve disadvantaged populations better?

When you do not have enough resources, you put out fires. In a city like São Paulo, the stratification is very clear: The oldest and wealthiest district, home to 2 million people, has an average of 13 hospital beds per 1,000 inhabitants. In 71 other districts of more recent development, there are 0.6 hospital beds per 1,000. Four million people live in areas where there are no hospital beds. To get 1.0 hospital bed per 1,000 inhabitants, the minimum acceptable, in São Paulo we would need to create at least 10,000

to 12,000 new beds—that is 50 to 60 200-bed hospitals. Over the last decade, we built two. Why do we not build more hospitals? There is no money.

Could public-private partnerships resolve the impasse?

The Family Health program is largely administered, with good results, by nonprofit charities. The problem is that the private entity agrees to administer but does not want to put up money . . . Let us say we build a hospital with donations. Then we have to bring the hospital into operation and every year that costs twice what was invested to build and equip the hospital. This is the problem in health care: spending is permanent and growing.

Not only is there is a shortage of hospitals and beds, in some regions there is also a shortage of doctors. How do we incentivize more professionals to work in the countryside?

About 60% of doctors are in the capitals, which have just over 20% of the population. If we look at the statistics, the number of doctors is sufficient, but they are concentrated where we have hospitals. In inner cities and the North, areas with good economic development have no shortage of doctors. But even in well-developed cities, the problem is in the peripheral areas where the poorest live.

In 1996 we had 82 medical schools. Today there are 185, but 70% of the growth is in private colleges whose tuition fees are not affordable for most people. And those who do graduate in these universities spend up to R$6,000 per month and are not willing to work outside large cities. The problem is very complex. We are aware that the number of doctors in the country is small. We need more doctors, but not just any doctor. Colleges must have the quality to form a professional who is able to serve the population safely.

What is missing?

We lack awareness. For example, when we created the CPMF, it was forbidden to share information with the IRS. Everardo Maciel, who was the revenue secretary, decided to share information and found that 62 of the 100 largest contributors to the CPMF had never paid income tax. The government is going after them, but everything is very slow. In Brazil we specialize in criticizing and demanding. We need fewer people who criticize and demand, and more people to help find solutions. If everyone did a thorough examination of their conscience, they would find that they could do something.

How could the private health sector grow healthily and support the public health system?

When I was health minister, I insisted

When you do not have enough resources, you put out fires.

that when the public health system treated a client of a private health plan, the plan should pay the full amount it would pay to private hospitals. Instead the agreement stipulated that health plans would pay what the SUS would pay, which is much lower—and even so, they are not paying it. This needs to be corrected.

The idea that we spent badly and that the problem is resource management is a hasty analysis by those not familiar with the health system.

Has your vision of the health system as a physician changed since you were a minister?

No, it has not changed. I always made a distinction between those who deal with economics and those who work in the health sector. Those who deal in the economic area are always very close to wealth and have a hard time understanding the problems of poverty. Staff in the health area . . . is much more aware of the deficiencies and problems than people in the economic sector. This is a great difficulty. In several sectors, when the work is finished, spending stops. In the health sector, when the work ends, the spending begins, and that expense is permanent. ■

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Will Brazilian industry do better in 2012?

Claudio Accioli, Rio de Janeiro

A major contributor to the country's disappointing economic growth of only 2.7% of GDP in 2011, Brazilian industry is suffering from a combination of such factors as the global crisis, unfavorable exchange rates, and intensified competition from imports. After registering growth of 10.4% in 2010—an impressive recovery from the 5.5% drop in 2009—industrial GDP ended last year with growth of a mere 1.6%, casting doubts on its performance in 2012. Overall industrial output, which includes the important manufacturing segment, was virtually stagnant: growth was 0.3%, compared to 10.5% in 2011.

According to the February IBRE Economic Outlook, this year began with encouraging signs, despite a drop of 2.1% in industrial production in January compared to December in seasonally adjusted terms. The proportion of businesses with excess inventories fell from 8.5% in October to 5.1% in January, a level below the historical average of 5.6%. This suggests room for some recovery of economic activity ahead as industry rebuilds inventories. Likewise, according to the IBRE Industrial Sur-

vey, planned production has shown improvement recently. However, business expectations are clouded. For the next three months, expectations are neutral but over a longer horizon the predictions become explicitly pessimistic. In summary the IBRE Outlook says, "The result reflects an industry sensitive to the measures of monetary easing and fiscal stimulus announced at the end of last year, but with little drive to hire workers and invest."

Moderate recovery

The diagnosis agrees with the evaluation of two major representatives of the sector. Renato da Fonseca, executive manager, Research Unit, National Confederation of Industry (CNI), reports that CNI surveys show a tendency to maintain the pace of decline in industrial production in early 2012. "Capacity utilization has been below normal since December 2010, and there is no evidence that the adjustment in inventories is sufficient for a vigorous and immediate resumption of production. Still, one should remember that we are in a low period of industrial activity, which usually reaches its peak around October. There is room for recovery," says Fonseca, adding that the CNI predicts growth of 2.3% for industrial GDP in 2012, and about 3.0% for the economy.

Julio Gomes de Almeida, economist, Institute for Industrial Development Studies (IEDI), agrees that low inventories may have limited impact on growth and points out another limiting factor: "We should have a better year than 2011, but not much better because there remains a factor responsible for the low growth in recent years, which is the problem of industry's low competitiveness. Unless we have very relevant facts for 2012, I do not see how to overcome it immediately."

Brazilian industry is suffering from a combination of such factors as the global crisis, unfavorable exchange rates, and intensified competition from imports.

The February IBRE Outlook shows that production in 2011 was strongly and negatively influenced by two major indicators of competitiveness: unit labor costs (ULC) defined as the ratio between the payroll in U.S. dollars and quantity produced, and the coefficient of import penetration, defined as imports and total domestic output. "Both have increased significantly, the first mainly due to increases in real wages and a decline in labor productivity," says IBRE Outlook coordinator Regis Bonelli. He explains that the ULC has increased 122% over the past nine years. For imports, the

Business expectations are clouded. For the next three months, expectations are neutral but over a longer horizon the predictions become explicitly pessimistic.

coefficient of penetration rose from 10.3% in 2003 to 20.4% in the third quarter of 2011.

"In a healthy economy, wage policy should accompany the increase in productivity, i.e., as workers become more productive, their wages increase. That happened in the first half of the decade. Now, wages are growing and productivity is not, but much of the movement can be credited to exchange rate appreciation, which increases the cost of labor measured in dollars," says CNI's Fonseca. IEDI's Almeida also does not hesitate to point out the exchange rate as the culprit causing lower industrial competitiveness in Brazil. He says, "An extraordinary and intense appreciation of our currency absolutely disrupts domestic industry. In my view, the competitive gap due to the appreciated exchange rate is about 50%, while productivity gains are only about 3% to 4%."

Fonseca admits that not all evils can be attributed to the exchange rate, and that productivity deserves attention: "Part of low productivity recently is related to the lack of skilled workers. The Brazilian economy grew and unemployment is very low, which means that companies have hired workers who are not adequately trained to perform their activities. It is a structural problem, which involves investment in education and innovation, but the macroeconomic environment prevailing until recently, with extremely high interest rates, discourages such action on the part of entrepreneurs."

The Brazil cost

Factors beyond industry's control also affect its competitiveness. Fonseca explains that "Logistics, for example, does not depend on the company but increases the cost of goods from factory to consumer. Brazil has also had one of the lowest industrial electricity costs among developed and developing countries, but today, because of taxes, it has one of the highest, second only to Italy." Almeida agrees: "An emerging country that wants to reach the standard of living of developed countries cannot have the most expensive taxation and cost of capital, energy, logistics, payroll taxes, and wages. Currently industry is paying for not only its own sins of not having better productivity, but also the sins of others. This makes it difficult to compete."

Both economists agree on the effects of increased import penetration on industrial production. "Why do retail sales grow more than industrial production?" Fonseca asks. "Because part of consumption is going to imports. And why is industry revenue growing more than production? Because inputs in the production are being replaced by imported inputs, i.e., the added value is falling. This means that we find it difficult to compete in both domestic and foreign markets." In the same vein, Almeida highlights the vulnerability of industry compared to other segments of the economy: "The agricultural sector in Brazil is very productive and has benefitted by highly favorable international prices, and the services sector in the majority of cases does not suffer from competition from imports."

For 2012, among the factors that may justify some optimism about the performance of Brazilian industry Almeida highlights the measures taken as part of the Great Brazil Plan, such as exemption from payroll taxes and investments in selected sectors, as well as the reduction in the basic interest rate, fewer requirements to obtain credit, and raising the minimum wage. "All this is not trivial, and should represent an increase in consumption of food and beverages, which employ many workers, have great weight in the industry as a whole, and are not as exposed to imports. [Industry] should grow more than in 2011," he says. Fonseca adds, "If I said that the government has not taken action, I'd be lying. But we must reinforce the sense of urgency, because we cannot miss the great opportunity to increase the country's competitiveness through structural reforms."

"Wages are growing and productivity is not, but much of the movement can be credited to exchange rate appreciation, which increases the cost of labor measured in dollars."

Renato da Fonseca

"An emerging country that wants to reach the standard of living of developed countries cannot have the most expensive taxation and cost of capital, energy, logistics, payroll taxes, and wages."

Julio Gomes de Almeida

PERU'S
unfinished work



Lima City, Peru

Photo: Michael Reeve/Wikipedia.

Despite successful macroeconomic management and the good performance of its economy in recent years, structural reforms to ensure that government is more efficient and transparent and that the private sector is profitable are critical to Peru's sustainable economic growth.

Solange Monteiro, Rio de Janeiro

After consultant Guillermo Quintana completed his MBA in the United States, against his friends' expectations he returned to Peru, where since 2010 as director of Peru Ventures he has led economic development projects in poor communities. "Today," he says, "terrorism has largely disappeared, and we have a very positive business environment and more credit."

Quintana is not alone. From 2007 to 2009, according to a study from the National Institute of Statistics

and Informatics (INEI), 76,500 Peruvians came back home. Although the international crisis spurred this re-migration, optimism about Peru's economy is also a factor: 30% of returned expatriates had lived in Chile, the prime destination for Peruvians who seek better living conditions and the country perhaps least affected by the American crisis.

Over the past decade, average growth in Peru has exceeded 6%, and poverty fell from 50% of the population to 31%. "Currently, Peru shows a stable and solvent economy," says Andrés Remezzano, an Argentine who is manager of economic studies at Deloitte and author of *Inkanomics, Notes on the Peruvian Economy*. The first six months of the Ollanta Humala government, he adds, demonstrated that the nationalist candidate is committed to macroeconomic discipline: "This is critical. Among the countries in the region that are most attractive for foreign investment, such as Brazil, Chile, and Colombia, Peru is still the poorest. Therefore it is very important to ensure the continuity of current policies, and to invest in strategic areas such as mining, communication, finance and infrastructure."

IF ALL GOES WELL

According to Remezzano, unless there is a drastic drop in the purchasing power of China and its major trading partners, Peru should grow by 5% in 2012.

At a third of GDP, Peru's international reserves can meet demand for imports of goods and services for 18 months.

Last year, GDP grew 6.9%, driven mainly by private consumption and investment. Should the international outlook deteriorate, Juan José Marthans, former director of the Peruvian Central Bank and now director of the Center for Financial Markets Research at the University of Piura, points out that at a third of GDP, Peru's international reserves can meet demand for imports of goods and services for 18 months.

Peruvian model

High savings and investment have brought about higher GDP growth.

Years	Investment (% of GDP)	Domestic savings (% of GDP)	GDP (% change)
2001	18.8	16.5	0.2
2002	18.4	16.4	5.0
2003	18.4	16.9	4.0
2004	17.9	17.9	5.0
2005	17.9	19.3	6.8
2006	20.0	23.2	7.7
2007	22.8	24.2	8.9
2008	26.9	22.7	9.8
2009	20.7	20.9	0.9
2010	25.4	23.7	8.8
2011	25.6	24.3	6.9

The shortage of skilled labor is of more concern than such other important issues as competitiveness and even confidence in government policy.

"Moreover, if the price of copper falls, we still have gold, which historically is a haven in times of volatility and can help offset losses [from copper]," he says.

Marthans believes that growth in consumption in Peru is based on prudent credit expansion and cites the high level of private investment, which in the last two years was about 19% of GDP. "We live in an environment of more profitable long-term capital flows, and we apply controls to mitigate distortions in the short-term market," he says. "Here, controls include increasing taxes or bank reserve requirements. With a financial system that is small and unsophisticated—only 12% of GDP—efficiency is not achieved through monetary policy," he says. In 2011, the reserve requirement was 25% for deposits in domestic currency and 55% for foreign currency deposits. "The exchange rate has been less volatile than for many currencies in the region, though there is occasional need for central bank interventions," according to Marthans.

Another factor boosting the economy, though to a lesser extent, is microcredit: the Peruvian model is one of the most successful in Latin America. The Inter-American Development Bank (IDB) ranks the country as the best environment for microfinance in the region, with the largest portfolio, totaling US$4.9 billion.

BUT NOT ALL GLITTERS

Nevertheless, Peru still needs to overcome several shortcomings, some of them related to infrastructure. In diversifying exports, for example, one of the highlights is agricultural products like asparagus, of which Peru is the world's leading exporter. To expand the agricultural sector, it would require heavy investment in seeking sources of more water to prevent the overexploitation of aquifers.

Lack of water also affects growth in the arid Lima region, which holds 88% of the population and only 1.8% of Peru's available water. The threat of drought in Lima is also a reason for more development of the countryside, opening roads to other regions where water is plentiful, as in the Amazon. Remezzano identifies one problem, however: "Growth is not being accompanied by enhancement of the execution capacity of regional governments." Quintana confirms that "Often the money is available,

but technical capacity is deficient." The problem is generally recognized. A survey of Latin America done by the German Ifo Institute (Institute of Economic Research, University of Munich) and its partner the Getulio Vargas Foundation points out that the shortage of skilled labor is of more concern than such other important issues as competitiveness and even confidence in government policy.

What causes the greatest gridlock, however, is social and environmental movements against large mining and energy projects. The Humala administration has become less tolerant of such movements, though their members supported his election. Recently, for instance, there was a sequence of demonstrations against the Conga gold mine in Cajamarca. A joint project of the US Newmont and Peru's Buenaventura, it is estimated at US$4.8 billion; the plan to mitigate its environmental impact is currently being reviewed.

Without discussing their merits, Carlos León of the Institute of Political Science, Catholic University of Peru, says a big problem with the demonstrations is that "Each group has demands and they do not meet with each other," which complicates negotiations. León believes the demonstrations are a reaction to the arrogance of some companies that have been operating in Peru. In an attempt to solve that problem, last September Humala promulgated the Law of Prior Consultation, which requires companies to consult with indigenous peoples and other residents before projects begin that would directly affect their rights.

Peru's free trade agreements with countries on the Pacific rim make life more difficult for Brazilians.

The uncertainty has also affected Brazilian companies. According to a survey by the Center for Development and Integration Studies (CINDES), in 2010 Peru was one of the main destinations for investment by Brazilian companies: more than US$1.7 billion went for energy and ore projects, and another billion dollars was spent to buy a Peruvian mining company. CINDES indicates, however, that in 2011 Brazilian investment came to a halt and some projects were even canceled.

Eletrobrás (Brazilian Power Company) is studying the possibility of a 6,000 MW power project in Peru. The company said the new government is still redefining the energy agenda. Of the projects listed in the Energy Integration Agreement signed between Brazil's Lula and Peru's Alan García in June 2010, the most developed is the plant on the river Inambari in the south, which was in the final phase of the feasibility study

but was cancelled by the Peruvian government in June 2011.

ROOM FOR TRADE TO GROW

In the commercial arena, although as yet Peru takes in less than 1% of exports from Brazil, it is attracting attention from several Brazilian companies. Among them is the Metalli Milani, whose main export is copper parts for the steel industry. With customers in Chile, Mexico, and Spain, in 2011 Metalli decided to move into the Peruvian market. "The decision is part of our strategy to increase the export share of our revenues from the current 27% to 50% by 2013," says Anderson de Araújo, supervisor of the company's commercial area. In the food sector, the MBR Company at the end of last year began marketing within the region; until then, the company's fresh fruit exports were all going to Europe. In 2011, MBR moved into Chile, where it is negotiating the sale of foods such as oils, fruit juice, and breakfast cereals. "Since then we have made our first contact in Peru with a preservatives and dyes industry looking for new suppliers for exotic products such as annatto, turmeric, and other seeds they usually import from Asia," says Fernando Barbosa Ferreira, MBR executive.

Ferreira acknowledges, however, that proximity does not give it an advantage over competition from Asia. "Our logistics costs today are the same as



"Photo: Wikiperuvian.

A businesswoman ready to take on the free market.

for a delivery in Dubai or Germany," he says. Peru's free trade agreements with countries of the Pacific make life more difficult for Brazilians. Last year, trade agreements with China, Thailand, and South Korea entered into force; in March, it will be the turn of Japan, paving the way not only for trade in goods and services but also for attracting direct investment.

To Marthans, however, the trade agreements do not dilute the importance of neighbors like Chile and Brazil. "We have an extraordinary potential, but we need partnerships, and especially the support of human capital in these countries," he says. "The important thing now is to persevere with structural reforms to ensure basic services for the population, a more efficient and transparent government, and the profitability of the private sector."

In 2012 the Brazilian economy is now expected to grow about 3% and inflation to decline to 5.2%, with the benchmark interest rate ending the year at 9%. Major risks to the outlook are European financial uncertainties and stagnation in domestic manufacturing.

At the end of 2011, Brazil's economic indicators confirmed a modest recovery, suggesting that the worst of the downturn was behind us. However, contrary to all the expectations, the outlook has clouded to some extent. A surprising drop in industrial production in January calls for downward revision of economic forecasts for 2012.

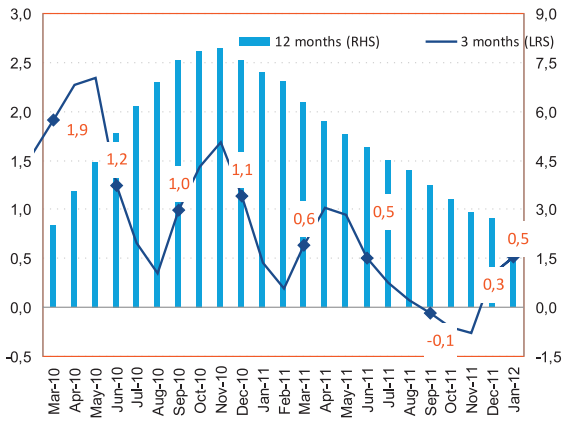
Nevertheless, we continue to predict a mild recovery and GDP growth of about 3%, but several factors are slowing the recovery. On the supply side, manufacturing is likely to stay feeble because its competitiveness has been undermined by exchange rate appreciation and slow productivity growth: the unit labor cost, measured by a basket of currencies, has risen by 122% over the past nine years. In agriculture crop yields are not likely to repeat last year's performance, and the service sector cannot be expected to grow quickly.

On the demand side, hopes are focused on household consumption, driven by credit availability and higher incomes, and on more robust growth in gross fixed capital formation. Household consumption, however, may be lower than hoped; it is constrained by indebtedness and the end of a durable goods purchasing cycle. And the recovery of gross fixed capital could cool because of the uncertainty about European finances.

Supporting this scenario, although IBRE's monthly economic activity indicator had been growing since November 2011, the cumulative 12-month rate fell from 2.7% in December to 2.5% in January. An intriguing aspect of the lukewarm current scenario of economic activity is the good performance of the labor market, where unemployment is low and stable.

IBRE Economic Activity Indicator, March 2010-January 2012

(Percent change over the previous quarter and 12-month moving average over the previous 12 months, seasonally adjusted)



Sources: IBGE and IMF; IBRE staff estimates.

Inflation is expected to decline from 6.5% in 2011 to 5.2% in 2012, mainly because moderation in food price increases should continue in the second quarter. However, inflation in services prices is preventing a greater reduction in the inflation rate.

Our scenario assumes that the central bank will continue its monetary easing policy, cutting the benchmark interest rate to 9.0% by year-end. But it appears that the trade-off between growth and inflation in Brazil has worsened: there will be lower growth, but inflation will remain high. Lessening this trade-off is a major challenge for policy makers.

Risks to the outlook

Recent restructuring of Greece's debt and aggressive expansion of bank liquidity in Europe by the European Central Bank may stave off a deeper crisis in Europe and for the time being has reduced the likelihood of a sharp slowdown of the world economy. Another downside risk to Brazil's growth is the stagnation of the manufacturing industry, despite the monetary and fiscal stimulus. Clearly, the structural problems of Brazilian industry cannot be resolved in the short term. Resumption of growth based on increased domestic demand without the necessary supply may further deepen imbalances in the economy, with negative effects on potential growth.

Brazil in step with world growth (% change)

