THE BRAZILIAN ECONOMY

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The BRAZILIAN ECONOMY

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The government is betting on an aggressive protectionist industrial policy to make Brazilian industry more competitive, but opinion is divided on how effective that will be. Claudio Accioli interviews experts and reviews some of the history of industrial policy; that history is not promising, the risks are high, and although the experts may disagree about how effective protectionism will be, they generally agree that what is really needed is to improve the business environment.

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Ozires Silva, former Minister of Infrastructure, former president of Embraer and Petrobras, and now dean of Monte Serrat University, has seen where Brazilian business fits into the world economy from every possible angle. He explains to Claudio Accioli how Brazil can engage effectively in the tough competition imposed by emerging Asia, especially China and South Korea.

ROUNDTABLE

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The OECD says world food supply will need to increase 20% in 10 years to meet demand, and expects that Brazilian agriculture will have to contribute about two-fifths of that. In March, two units of the Getulio Vargas Foundation presented the first Roundtable on the Agribusiness Scenario, and experts there identified problems Brazil's agriculture sector must deal with to ensure that it retains its current global prominence. Thais Timotheo reports on implications for Latin America as a whole and analyses a case of new agricultural technology from Monsanto.

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"When the economic situation is satisfactory but industry is not going so well, what should we do?" Luiz Guilherme Schymura asks. The answer, he says, is that "Since industry is apathetic, the world economy is uncertain, and bringing about devaluation is difficult, we should therefore move to address the 'Brazil cost.'"

ECONOMY

39 IBRE April economic outlook

The Brazilian economy is recovering, but more slowly than expected. Low inflation, high employment, and income growth are promoting recovery, but lack of dynamism in industry and an expected slowing down of purchases of durable goods will act as a brake.

ECONOMY

Unemployment and wages up in February

Brazil's unemployment rate rose to 5.7% from 5.5% in January, the government statistics agency IBGE announced. However, February's jobless number was the lowest for the month since 2002, indicating that the Brazilian labor market was largely unaffected by the country's economic slowdown in the second half of 2011. Wages adjusted for inflation rose 1.2 percent from January to R$1,699 (US$931)—4.4% more than a year earlier. (March 22)

External trade surplus highest since March 2007

Exports exceeded imports by US$2 billion in March, up 30% over March 2011 and the best result for the month since 2007, according to the Ministry of Development, Industry and Foreign Trade. Both exports, at US$21 billion, and imports, at US$19 billion, set new records. (April 2)

Manufacturing output up in February

Industrial production grew 1.3% in February, after falling 1.5% in January, according to seasonally adjusted IBGE data. Compared with February 2011, however, production fell by 3.9%, the sixth consecutive decline. So far in 2012 the industrial sector is down by 3.4%. (April 3)

Inflation lower in March

Brazil's official consumer price index rose 0.21% in March, slowing from a 0.45% rise in February mainly because inflation was lower for all items but food and transportation. (April 5)

TRADE

BNDES and Interbank finance machinery exports to Peru

On March 12 the National Bank for Economic and Social Development (BNDES) and the Banco Internacional Del Perú S.A.A. (Interbank) signed a contract to finance Brazilian exports of machinery and equipment to Peru. A line of credit up to US$50 million was established. The partnership between the BNDES and Interbank will promote trade between Brazil and Peru and present new opportunities for their financial cooperation. (March 13)

Mexico bows to Brazilian pressure on auto exports

Mexico has agreed to reduce its auto exports to Brazil to an average of about US$1.6 billion over the next three years, bowing to Brazilian concerns about its ailing industrial sector. Mexican car exports to Brazil jumped by around 70 percent in 2011, aggravating a glut of cheaper imported autos in Brazil. The quota is the latest in Brazilian government efforts to protect the industry. Free trade between the two nations will resume after three years. However, the accord fell far short of what Mexico said it would fight for, and prompted harsh words from Mexican free trade advocates. (March 15)

POLITICS

President shuffles government leaders

President Dilma Rousseff ousted her floor leaders in both houses of Congress in a move seen as an effort to quell signs of unrest within the governing coalition. Sen. Romero Juca of the Democratic Movement Party (PMDB) and Rep. Candido Vaccarezza of the Workers' Party (PT) stepped down so that the president could introduce rotation of the posts, which are the administration's main points of contact with each chamber. The PMDB's Sen. Eduardo Braga replaces Juca and the PT's Rep. Arlindo Chinaglia replaces Vaccarezza. According to Rep. Jeronimo Goergen (government-allied Progressive Party), "It's no use changing the leaders or ministers … because they will always require authorization from President Rousseff for everything they do. This is a general complaint among members of the coalition." (March 15)

DEFENSE

Embraer supplies aircraft to African nations

Embraer Defense and Security has signed contracts with three African nations to acquire its A-29 Super Tucano light attack and advanced training turboprops: Burkina Faso, Angola, and Mauritania. Total value of the contracts—which include an extensive logistical, training, and replacement parts package—is more than US$180 million. (March 28)



Photo: Embraer

A-29 Super Tucano light attack and advanced training turboprop.

FOREIGN POLICY

BRICS demand better representation at the IMF

Leaders of the world's most powerful emerging economies have threatened to withhold financing that the International Monetary Fund has requested to fight the European sovereign debt crisis unless they gain more voting power at the IMF. Shareholders agreed in 2010 to shift more IMF voting weight toward emerging nations. However, the U.S. has not yet passed enabling legislation.

Meeting in India, heads of state from Brazil, Russia, India, China, and South Africa said there was an urgent need for the IMF to "better reflect economic weights" and "enhance the voice and representation of emerging market and developing countries … The ongoing effort to increase the lending capacity of the IMF will only be successful if there is confidence that the entire membership of the institution is truly committed to implement the 2010 reform faithfully."

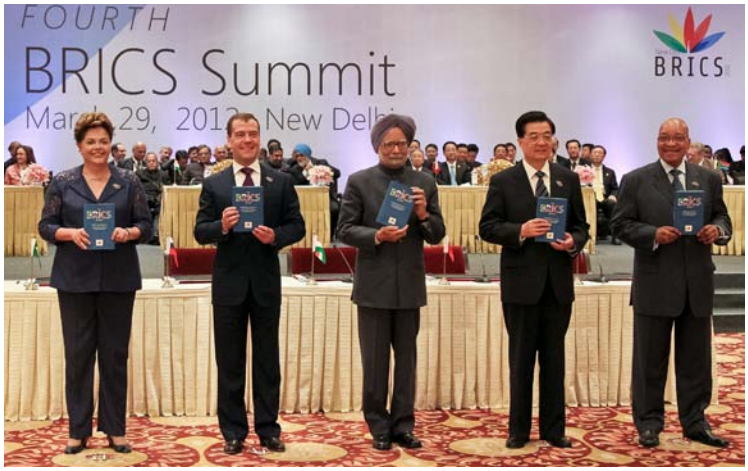

Photo: Roberto Stuckert/ABr.

Presidents Dilma Rousseff (Brazil) and Dmitri Medvedev (Russia), Prime Minister Manmohan Singh (India), and Presidents Hu Jintao (China) and Jacob Zuma (South Africa).

The BRICS leaders also criticized western countries for their handling of the global economy in the aftermath of the financial crisis. President Dilma Rousseff charged that western countries had caused a "monetary tsunami" by adopting aggressive expansionist policies that are undermining the competitiveness of emerging economies. (March 30)

ECONOMIC POLICY



Photo: Wilson Dias/ABr.

President Rousseff anounces new measures to support domestic industry.

Brazil extends tax on foreign borrowing

By presidential decree, Brazil extended the application of a 6% tax on foreign borrowing to debt with maturities of up to five years, rather than the two-year maturity limit that prevailed through February. The tax is charged when Brazilian companies issue bonds for foreign loans. The Rousseff government is concerned that foreign cash flows into domestic financial markets could force appreciation of the Brazilian currency, derail a feeble recovery, and further suppress industrial competitiveness. (March 12)

Brazil cuts taxes, boosts financing for industry

To aid industry the government has announced a stimulus package of US$35 billion (1.5% of GDP) that reduces payroll taxes and social contributions, increases funding for state development bank (BNDES) subsidized loans, and raises import taxes. Separately, Finance Minister Mantega pledged to take additional measures to stem currency appreciation. (April 3)

Largest February primary budget surplus posted

In February Brazil posted the largest primary budget surplus (excluding interest on public debt) since data collection began in 2001, a response to the government's efforts to rein in public spending and bring interest rates down. The consolidated primary budget surplus was R$9.5 billion (US$5.2 billion). In the 12 months through February, the primary surplus was equivalent to 3.3% of GDP, unchanged from January. (March 30)

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Why protect inefficiency?

There's an old saying that insanity is doing the same thing over and over and each time expecting different results. And isn't that what the new industrial policy is doing with its protectionist measures?

As our cover story points out, between 1998 and 2008 Brazil had a policy of protecting the information technology industry. How successful was it? Well, for the individual companies that benefited, productivity went up significantly and so did their investment in R&D. Yet at the end of a whole decade, 26 countries still outranked Brazil in IT competitiveness—our position in the global market hadn't budged from 27th.

One of the interesting aspects of the cover story is that not one of the independent experts consulted thought protectionism was a good idea. Only those affiliated with the government came to the defense of the concept. And even they recognized that Brazilian industry has serious structural problems that protectionism won't solve. That's not even taking into account the essential unfairness of favoring some industry segments with incentives and not others.

The bigger problem of the new industrial policy, though, may simply be that protectionism encourages inefficiency, and discourages company investment.

What no one seems to be considering either is the extent to which protectionism could encourage corruption. President Rousseff has already made the fight against corruption a hallmark of her administration. Yet in expanding grants and granting tax breaks for certain industries—so that in essence the taxpayer is subsidizing those industries—isn't the administration also creating incentives for corruption? It isn't hard to see the lobbyists converging on our representatives, many of whom already have a somewhat grubby reputation for regularly having their hands out. To find the fruits of corruption, we simply need to follow the money—and there's a lot of money at stake in these protectionism measures.

The bigger problem of the new industrial policy, though, may simply be that protectionism encourages inefficiency, and discourages company investment. As Pedro Cavalcanti asks in the article, "How many years are necessary to protect certain industries? 20? 30? And who pays for the loss of productivity during all this time?" We know the answer to that question: again, taxpayers. Or maybe more precisely, domestic consumers, who in addition to supporting badly run businesses as taxpayers must also pay twice as much for what they need because Brazilian products cost so much more to make than the imports to which the government has barred the door.

Another question is whether protectionist policies are simply a way to keep dying businesses on life support when the kindest thing to do for all of us would be to pull the plug. Does anyone remember the Merchant Marine Fund in the late 1970s and early 1980s? The fund financed an aggressive policy to protect shipbuilding? And how well did that work? In the 1970s, Brazil was second in the world rankings behind Japan. Then the fund ran out of money. Today, South Korea and China are the world's top shipbuilders with Japan coming in third. Brazil's shipbuilding industry has simply disappeared.

In certain carefully constructed scenarios, with time limits and benefits phased out over time, protectionism can achieve its objectives. Unfortunately, Brazil has once again failed to construct its industrial policy carefully.

Not (yet) a political crisis

Is President Rousseff facing a governability crisis with her coalition allies? Probably not, at least not yet. Though the Senate rejected one of her nominations and a very small political party pulled out of the coalition, the problems are more symbolic than real. With approval ratings and economic indicators on her side, President Rousseff is retaining political capital. But for how long?

João Augusto de Castro Neves, Washington D.C.

Since February, President Dilma Rousseff has suffered two important setbacks in Congress. On March 8 the Senate rejected her proposal that Bernardo Figueiredo continue as head of the National Land Transportation Agency (ANTT), the autonomous regulatory agency tasked with overseeing the government's transportation infrastructure strategy. The setback sparked a decision from President Rousseff to replace the government's leaders in both the Senate and the Chamber of Deputies. Then, on March 14 the Party of the Republic (PR) announced that it was leaving the governing coalition in the Senate.

Many media pundits are suggesting that Rousseff may be facing a governability crisis with her coalition allies, but that appraisal is premature. The rejection of Figueiredo and the PR's defection were certainly setbacks, but their impact on governability should be kept in perspective.

In numerical terms, departure of the PR hardly changes the balance of power between the government and the opposition in Congress. Not only will President Rousseff still enjoy a comfortable majority in the Senate (without the PR the government still has 51 seats out of 81), but it is also doubtful, despite the formal defection, that the seven PR senators will close ranks with the opposition. The PR left the coalition because Rousseff would not allow them to nominate the replacement Minister of Transport, but the party is open to supporting the government case by case. This could allow the government to reestablish the relationship, or at least mitigate the risk of overt opposition.

As for the Figueiredo rejection, although it does not signal a full-fledged political crisis, it does highlight the government's relatively deficient coalition management.

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The main driver behind the rejection was dissatisfaction among Rousseff's allies, mainly the Brazilian Democratic Movement Party (PMDB), the largest party in the coalition, with the lack of space in the administration (i.e., its influence on government appointments). PMDB leaders feel that the party should control the more important ministries, or at least that it should have full control of the ministries it currently holds. But ever since last year's corruption scandals that affected several ministries, President Rousseff has taken a much more hands-on approach, which includes vetting second-tier positions in the cabinet.

So far the president has handled dissatisfaction within her coalition without difficulty. High approval ratings, sound economic indicators, and a severely weakened opposition have given her the political capital to squeeze her allies without compromising the government's reform agenda. In fact, the PMDB purposefully chose a not very crucial vote on which to manifest its dissatisfaction. Rousseff's response to the threat, however, was to reshuffle the leadership in both houses of Congress—an unusual maneuver when a legislature is in mid-session. Some believe her move was meant to punish the rebellion, which could ultimately backfire. But it is more likely that the strategy was meant to recalibrate her political coordination strategy and team, which further concessions on her part could confirm. The point is that these events should be viewed as mere grumblings within a governing coalition where the president still retains significant political capital, and all the conditions necessary to hold the coalition together are intact.

To protect itself from an eventual full-fledged political crisis, the administration sooner or later should rethink the way it is managing the government coalition.

Ultimately, the impact on the near-term reform agenda should be limited to slowing the speed of legislative activity. Since there is a window of opportunity until the July recess and local elections will dominate the second half of the year, the government is likely to keep pushing for its reform agenda through the next few months.

Nevertheless, to protect itself from an eventual full-fledged political crisis, the administration sooner or later should rethink the way it is managing the government coalition. With approval ratings and economic indicators on her side, President Rousseff is retaining political capital and ignoring the basic rules of coalitional presidentialism, that is, to share power and financial control. If those numbers change, it will be another story.


MADE IN
BRAZIL

The government is betting on an aggressive protectionist industrial policy to make Brazilian industry more competitive. However, the history of Brazilian industrial policy raises doubts about how effective this will be—attempting to shield industry from competition may well backfire.

Claudio Accioli, Rio de Janeiro

Discussion of industrial policy has a long history, starting with the Second National Development Plan (PND), which outlined Brazil's industrial policy for 1974 through 1979. Given the adverse global economic environment following the first oil shock, the PND set out an ambitious program of import substitution. Again, after the first, protectionist, Information Technology Law was passed, the discussion heated up: The law established a market reserve for industry, preventing the import of products and components in an attempt to defend national industry and encourage domestic scientific research. Though the law was relaxed in the early 1990s, the debate about protectionist preferences was reignited after the opening to car imports exposed the fragility of the Brazilian car industry, which barriers to entry had protected for years.

Today, in an unstable global economy and with increased competition worldwide, the government is returning to the policy of using laws, public funding, grants, procurement or special arrangements to promote national production and content in the petroleum, shipbuilding, defense, electronics, audiovisual, and automotive industries among others. As with any controversy, there is no consensus. For some, the policy is justified because industry is increasingly vulnerable and unable to compete, suffocated by the "Brazil cost" and by the flood of imported goods stimulated by an appreciated exchange rate. For others, it is a setback, a regression to the past that will only further disrupt the Brazilian industrial sector.

PROTECTIONISM ADVANCES

The Greater Brazil Plan launched last August was expanded this April with a package of incentives for industry to increase national content and innovation

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worth about R$60 billion (US$35 billion, 1.5% of GDP). The package extends preferences in government purchases to medicines, pharmaceuticals, biopharmaceuticals, and bulldozers produced domestically; creates the National Broadband Plan (PNBL), which exempts national equipment and infrastructure investment in telecommunications networks from taxes; expands incentives for national production of semiconductors; and sets out a new automotive regime for 2013–2017.

For good or evil, the Rousseff administration has made "defense of domestic industry and markets" an explicit goal. "We are seeking to implement the strategy as a way to leverage the current investment cycle in Brazil to encourage the supply of domestic inputs and produce, and add value to domestic industry," explains Heloisa Menezes, secretary of production development, Ministry of Development, Industry and Foreign Trade (MDIC).

In the case of financing, the idea is to extend to other official banks the concept of the Finame program of the National Bank for Economic and Social Development (BNDES), granting credit lines for purchase or production of machinery and equipment that have national content of 60% or more. To this end, the BNDES coffers were reinforced with another R$45 billion to reduce the cost and extend the period for loan repayments.

As for utilities concessions, the MDIC plans to extend the 1999 model in the oil and gas segment in which the National Petroleum Agency (ANP) requires bidders to document in tenders a minimum percentage of national content.

The Greater Brazil Plan also gives tax breaks for acquisition of local goods and services and for investments in research and development (R&D). The new automotive regime grants automakers more exemptions from the industrial product tax (IPI) if they increase the domestic content of components.

COMPUTER INDUSTRY

Since for a long time protection efforts and nationalization focused on information technology, that history allows us to assess how well protectionist policies work. In 2010 at the request of the Ministry of Science and Technology the Department of Science and Technology Policy Institute of Geosciences of the University of Campinas (Unicamp) did a study of how the IT Law affected IT sector performance between 1998 and 2008. Unicamp found that the

total income of beneficiary companies nearly quadrupled, productivity grew 42% more than in companies without incentives, and investment in R & D increased 30%.

However, this did nothing for Brazil's position in the global market. In 2008, according to the OECD and the United Nations, Brazil ranked 27th among IT exporters—just as it had in 1998. In those 10 years, the Unicamp study pointed out, while Brazil's annual exports doubled from US$1 billion to US$ 2 billion, South Korea's shot up from US$34 billion to US$114 billion and China's from US$$26 billion to US$79 billion.

Researcher Mauricio Canêdo Pinheiro, Brazilian Institute of Economics of the Getulio Vargas Foundation (IBRE-FGV), believes the IT case proves that policies to encourage local content in Brazilian industry are inefficient and need to be rethought. In IT, he says, "Brazil has not become an international player; it cannot sell its electronics other than in the domestic market." Pinheiro is also critical of domestic content rules for the oil industry: "For years this has been a requirement of the National Agency of Petroleum, but with only one or two exceptions, there is no evidence that domestic suppliers are becoming more competitive internationally."

The Greater Brazil Plan launched last August was expanded this April with a package of incentives for industry to increase national content and innovation worth about R$60 billion (US$35 billion, 1.5% of GDP).

Economist José Márcio Camargo, Opus Investment Management, cites another problem: "Petrobras is working with a high rate of local content. Since the government is the majority shareholder, there is a direct cash transfer from the taxpayer to the producers, whether in the form of tax advantages or of accepting a smaller profit." Camargo says the domestic content requirement in fact assumes that local products are less competitive than imported; otherwise, the protection would not be necessary. "This causes two distortions," he says. "If the domestic product is more expensive but the same quality as the imported one, it becomes less competitive in terms of price. But if it is more expensive and of substandard quality (which is very likely), it becomes less competitive because of both higher price



Photo: Vladimir Platonow/ABr.

Measures to increase the national value-added are intended to promote the defense systems industry, particularly Brazil's nuclear submarine project.

For good or evil, the Rousseff administration has made "defense of domestic industry and markets" an explicit goal.

and decreased productivity in the industry as a whole."

Economist Pedro Cavalcanti, FGV Graduate School of Economics (EPGE), has similar concerns, saying ."Certainly industry productivity will be affected—if it has not already been, because the data show stagnation in recent years. ... We have adopted almost perpetual protection for various sectors of the economy without achieving any positive results. An industry that has skilled workers and productive capacity would not need this kind of advantage."

The circle is vicious: The more protection, the less productive and competitive an industry becomes, which in turn calls for more protection.



SUNSET PROVISONS

The main shortcoming of Brazil's protectionist policies is that they have no sunset provisions. Pinheiro explains, "International experience shows that industrial policies fully achieve their objectives only if they have a set time limit and benefits decrease over time. This is not the case with Brazilian protectionist policies. The way it is done here, the tendency is to create a captive domestic market, with higher prices and no prospect of becoming internationally competitive."

"How many years are necessary to protect certain industries? 20? 30 years? And who pays for the loss of productivity during all this time?" asks Cavalcanti. Throughout Brazil's economic history, productivity has always grown when domestic markets were opened up to external competition. "In the long run," Camargo adds, "restrictive and protectionist measures have always taken the Brazilian economy backward."

Pinheiro points out that Brazil's industrial policies are counter to those that produced the successful industrialization of Japan, Taiwan, Singapore, and South Korea, who used every means available to bridge the technological gap—from shared investments to joint ventures and importation of machinery and

equipment. He describes how it was done by South Korea, a leader in shipbuilding: "First, they became competitive by gaining efficiency in any way possible, buying ship parts where the price was best. Once they established their reputation as a major international player, they focused on local content just as the other countries did."

Pinheiro thinks the Brazilian Aeronautics Company (Embraer) is a shining example of how well this recipe works. He explains that "Brazil has become competitive in the sale of medium-sized aircraft in large measure because Embraer is free to purchase parts and equipment wherever is most advantageous.... The company has a local production chain in São José dos Campos city in São Paulo state, but most of its supplies are imported. If it were required to purchase them in Brazil, it would probably be off the market in two years."

ASIAN LEAP

However, others see differences between Brazil and the Asian tigers. David Kupfer, professor of economics, Federal University of Rio de Janeiro (UFRJ) and consultant to the president of BNDES, points out that "In Brazil, over decades we have built up a very complex and diversified industry. We cannot ignore what already exists ... we need to restructure it and equalize with the international scenario. This is strategically very different from the situation of Asia, where industrialization was incipient."

The circle is vicious: The more protection, the less productive and competitive an industry becomes, which in turn calls for more protection.

Kupfer sees policies promoting local content as indispensable for stimulating competitiveness. "There is an ideal vision according to which the increase of local content would be a natural consequence of industrial development, a kind of indicator of the competitiveness of a sector," he says. "The higher domestic production, the more competitive the industry would be. However, we live in a time of major structural change, the result of globalization and fragmentation of world production, led by countries like China that industrialized late . . . In this context, policies to incentivize domestic content are a decisive factor for reintegrating Brazilian industry into the global production chain."

Glauco Arbix, president, Funding of Studies and Projects Agency (FINEP) of the Ministry of Science and Technology and member of the Greater Brazil Plan Executive Committee, agrees with Kupfer: "Because the world economy is placing severe restrictions on Europe, the USA, and Japan, there is a dynamic movement of the axes of production in which Brazil has to participate, as India and China are doing. This is an excellent opportunity for developing countries to restructure for the generation of

"International experience shows that industrial policies fully achieve their objectives only if they have a set time limit and benefits decrease over time. This is not the case with Brazilian protectionist policies."

Mauricio Canêdo Pinheiro

technology. It's the smarter way to take advantage of the crisis."

In Brazil, the issue of local content is still associated with protection of inefficient firms that cannot compete. "The problem is that any policy, any limitation to so-called free market activities is always subject to that criticism that there will be a loss of competitiveness," Arbix says. "However, no sector of the economy is closed or protected in such a way that knowledge-intensive areas cannot enter. Rather, what we are doing is making a great effort to attract the intellectual centers of multinational companies already operating here, in order to energize Brazilian industry."



Photo: Embraer.

Aircraft maker Embraer has become competitive globally without subsidies or protection from foreign competitors.

PROTECT TO COMPETE?

Kupfer thinks the incentives for local content need to be adjusted to the new national and international realities, but their importance should not be neglected. He highlights three areas of action: stimulus to productivity, technology, and innovation in segments, such as metal-mechanics, that were once at the core of industrial expansion but have lost competitiveness because of Brazil's years of disorganization and low macroeconomic growth; measures to support traditional industrial sectors where production conditions are challenged by international competition, such as textiles, clothing, footwear, furniture, foods, plastics and metal artifacts, and simple metallurgy; and support for technologies not yet fully developed by Brazilian industry, especially electronics, pharmaceuticals, and fine chemicals.

Whatever the strategies they argue for, all agree that the best way to protect domestic industry from foreign competition is to make it more competitive. The question is how. In specifying areas of action Kupfer seem to

go in two different directions: (1) help the most vulnerable sectors by granting tax advantages or setting prices, without necessarily requiring major expansion of local content or innovation; and (2) invest in new technologies that add value to products and effectively increase Brazil's ability to compete on equal terms with its main competitors.

For most experts, the first group would be most problematic. Without performance or innovation targets, protecting sectors just because they face heavy competition or an exchange disadvantage is a stimulus for inefficiency. "In the Greater Brazil Plan, the law giving preference in public purchases benefits mature and traditional sectors in Brazil that must compete with imported goods. In this situation, the policy is clearly a stopgap," says Pinheiro.



Throughout Brazil's economic history, productivity has always grown when domestic markets were opened up to external competition.

Camargo reinforces the point: "The company that knows it is protected in general does not invest. Look at the automotive industry. Our carmakers started up in the 1960s and Korea's in the 1980s, but we cannot compete with them. We always seem to be depending on a boost from government." He asks, "Suppose some of the shocks to industry are structural, and that some sectors have definitely lost the ability to compete, either because of costs or types of product. Will we protect them forever?" Cavalcanti adds, "The candle industry once was very important, but no longer once the light bulb appeared."

STRUCTURAL CHANGES

Mario Bernardini, economist and consultant to the Brazilian Association of Machinery and Equipment (Abimaq), thinks government procurement policy is a valid instrument for protecting and encouraging industry generally, even though it does not directly benefit the capital goods segment: "All developed countries use government power to stimulate and develop production. The United States has done this for decades, though they denounce developing countries that use this policy."

In Brazil, the issue of local content is still associated with protection of inefficient firms that cannot compete.

Yet Bernardini also asserts that such measures will do little to promote competitiveness without deep structural transformations. "We are reaping what we sow by choosing an exchange rate anchor to contain inflation," he says. Thus, domestic products cost almost double what imported goods cost. "The Greater Brazil Plan is not an industrial policy but a set of specific initiatives that ... do not solve the competitiveness problem. We need concrete goals to accelerate reduction of the Brazil cost."

Almost all analysts agree with Bernardini. Kupfer thinks the future of industry depends less on advantages associated with local content than on improvements in the business environment, a more efficient national economy, and efforts to train workers. Cavalcanti insists, "We must reduce the tax burden, invest in infrastructure, reduce bureaucracy, and cut payroll taxes. ... The aluminum industry has even thought of leaving the country, not because of the exchange rate but because of taxes."

TECHNOLOGY FRONTIER

While there is some consensus on the dangers of indiscriminate protection, there is also a conviction about the need for actions that promote innovation. Arbix believes that Brazilian companies can respond to the challenge, producing technological goods of a quality superior to what is offered overseas. "Take the case of oil," he says. "The frontiers of seismology, advanced physics, new materials, thermodynamics, and nanotechnology are focused on exploration and exploitation of deep sea oil. Is it reasonable that a country like ours, with a high caliber oil company like Petrobras and with significant oil reserves, has no company among the 100 most important in providing technology to extract oil in deep waters?"

Kupfer adds, "Brazil is investing in turbines for



wind energy production. Much of the value of the project is in the electronic sensor equipment—but we are not doing that part. … We should take advantage of this investment cycle to develop our own technology, which would certainly have positive spillover effects on other supply chains and helping to increase the competitiveness of industry as a whole."

But which sectors should be prioritized? Pinheiro gives priority to biotechnology and genetic research and to building on Brazil's comparative advantages in areas like agribusiness. Cavalcanti is "100% in favor of domestic investment in technology, research, and innovation in the areas where we have competitive advantages. This by nature involves risk, but that is justified by the possibility of high return. This is very different from subsidizing industries."

TIME TUNNEL

Protectionism carries risks. Past protectionist policies generated an extensive comfort zone for Brazilian industry. Pinheiro offers an example: "In the late 1970s and early 1980s, Brazil adopted an aggressive protectionist policy for the shipbuilding sector, financed by the Merchant Marine Fund. We were second in the world rankings, behind only Japan. But then came the oil shock, the fund ran out of money, and in a few years our shipbuilding industry simply disappeared because it was unable to walk on its own without government protection."

"Suppose some of the shocks to industry are structural, and that some sectors have definitely lost the ability to compete, either because of costs or types of product. Will we protect them forever?"

José Márcio Camargo

Local content policies should be tied to innovation and technology, targeted to sectors that have high capacity to spread knowledge, and focused on long-term results. "If such policies are applied widely and uncritically, they run the risk of becoming an instrument of short-term protectionism, generating only inefficiency," says Flávio Castelo Branco, executive director of economic policy, National Confederation of Industry (CNI).



Photo: Agência Petrobras.

The government wants to protect the national suppliers of capital goods for the oil and gas sector from foreign competitors.

The quest for global competitiveness

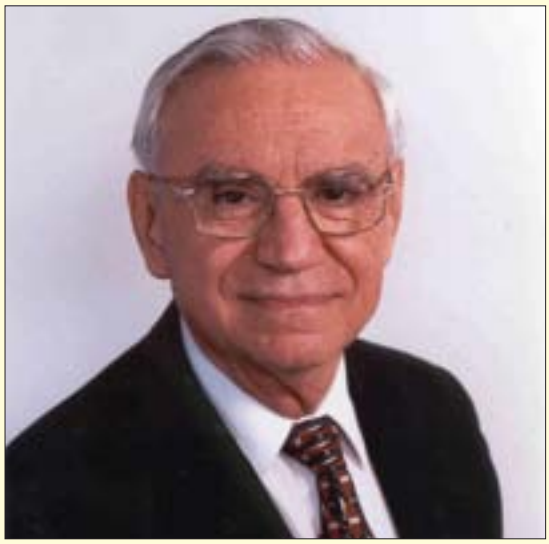

Photo: Divulgação.

Ozires Silva

Former Minister of Infrastructure and former president of Embraer and Petrobras

Claudio Accioli, São Paulo

Forty years ago Ozires Silva envisioned that Brazil would be a major player in international aviation. Twice president of the Brazilian Aeronautics Company (Embraer), the third largest manufacturer of commercial jets in the world, aeronautical engineer Silva, now dean of Monte Serrat University, explains how Brazil can prevail against the tough competition imposed by emerging Asia, especially China and South Korea. Having served as president of the state oil company, Petrobras, as Minister of Infrastructure, and as a reserve officer in the Brazilian Air Force, Silva has a uniquely broad perspective. He thinks the main obstacles to Brazil's competing successfully in world markets are the excessive presence of government in Brazilian life and the education deficit that undermines the quality of our workforce. But he also thinks that with the right effort such problems can be overcome.

***The Brazilian Economy*—Brazil made it through the international crisis more comfortably than most countries, but last year economic growth was below expectations. What do you think are the prospects for the Brazilian economy?**

Ozires Silva—I'm not as optimistic as the government. Without a doubt, the GDP of Brazil is lower than the country deserves. ... We have the false impression that the country is going well, but the numbers show that Brazil's external current account has only been balanced by capital inflows, which is problematic. . . . Covering the current account deficit that way generates a liability as the capital has to be paid back. We must have a vision for the future and propose strategies for development. We must give priority to education, which is absolutely fundamental for Brazil today. ... Brazil cannot reach the necessary revenue potential and profit more because of constraints than because of lack of incentives. We cannot do anything without requiring a government permit, which makes things difficult. The State is in every corner of Brazilians' activity . . . I often joke that in Brazil money is not at risk. What is at risk are the company,

employment, the entrepreneur, and the product. You must use money not just to generate more money but also to create value.

Of all the sectors, industry is performing worst. Is there a risk of deindustrialization?

Deindustrialization is already a reality in Brazil. Recently Renner, one of the oldest and most traditional textile companies in Brazil, began to sell Chinese products. What's worse is that these products are being paid for mainly by our export of commodities.

But more important than making a correct diagnosis of the situation is to know what to do. There are no magical measures, but something undoubtedly needs to be done about the [appreciated] exchange rate, which has been extremely harmful for the country . . . Brazil's competitiveness is far below that of our competitors . . . [but] the picture can change dramatically if [the exchange rate] is changed.

There is another aspect that has to be taken into account. I spent much time as a minister of state and realized clearly that the government is far removed from society. As a result the civil service distrusts the private entrepreneur. Meanwhile, if we look at two powerful examples of competing economies today, China and South Korea, we see that it is hard to distinguish what is the government and what is business; government and business interests are working together to create a competitive direction for those countries. Brazil would benefit greatly if we could replicate that close collaboration between the public and private sectors. That is all that we need to take action. The competition today is between countries. This is not company A in Brazil trying to compete with company B in China; it is company A, alone, having to compete with company B and its ally, the Chinese government.

In that context, what do you think of the Greater Brazil Plan, launched last year to support domestic industry and recently expanded?

The plan itself is comprehensive and well defined, but I think the media have not addressed the issue properly. They have emphasized the amount of tax relief and suggest that the federal government is not collecting taxes so it can help entrepreneurs. The correct view would be to show how much is being invested and what is the expected return, because if that money comes back, it is not a loss.

What is worrisome is how the measures will be carried out. We have complex laws to curb corruption, long, full of restrictions, but doing so is related

We must have a vision for the future and propose strategies for development, one of which must be to give priority to education, which is absolutely fundamental for Brazil today.

much more to education than to penalties. But the laws end up not being respected. I fought four years for the Innovation Law and celebrated when it was approved. The law is good, really innovative—but then the decree regulating it ruined it, so much so that we see no results.

We must join the world community, manufacturing and exporting products in which we're competitive and buying when we're not.

Are measures to protect Brazilian industry and encourage local content regressive?

To some extent, imports of foreign components have helped to improve the production of goods in Brazil. I see nothing wrong with that. We live in a globalized economy, in which old concepts such as 100% national goods don't apply any more. Even products made in developed countries have a lot of imported components, systems, and equipment. The computer is a good example. Just open one, in any country, and you will find parts from all over the world. The outdated idea that all components of products manufactured in Brazil must be essentially national returns us to the policy that prevailed from the 1970s into the early 1980s. We must join the world community, manufacturing and exporting products in which we're competitive and buying when we're not.

On the other hand, it's easy to list the incentives that we're giving for foreign companies to enter Brazil. High taxation, interest rates, labor and welfare laws, among others, all directly subsidize our imports.

How do you assess the "Brazil cost"?

We are lagging behind. There is no use adopting measures just to offset this cost, because they will create problems for us in the international market. Reducing production costs certainly would help. Of course there is a problem that must be faced: the government spends money it does not have, which has increased the tax burden. Infrastructure is something that you do not feel, but without it you do not move. And Brazil is stuck in this regard because the government has chosen to be. Until the new airport concessions, for a long time there were no utility concessions granted to the private sector, which has resources and appetite to invest. The government lost its managerial capacity, and that's what motivated me to fight for Embraer to be privatized. It was impossible to manage Embraer because the government had become a poor shareholder.

The premiums paid for the airport concessions were very large, much higher than expected, which shows the private sector is interested in investing

in infrastructure . . . If we hand over to the private sector everything we can in terms of infrastructure, Brazil would change with extraordinary speed.

You have headed up two major Brazilian companies. From the standpoint of management and governance, are we competitive?

No. But what the government does is crucial in determining whether Brazilian businesspeople manage efficiently. Much of the efficiency is lost in the government's huge bureaucracy. Jorge Gerdau Johannpeter, [president of the Gerdau Group], who is now in the government, says that in the United States his company has 3 employees to deal with paying taxes; in Brazil it has 200.

How do you explain Embraer's success?

When I became CEO of Embraer on January 2, 1970, there was no structure, just one office at the Aerospace Technical Center for company headquarters. From the beginning, I was concerned to create a competitive environment in the company . . . We would not seek subsidies or privileges. We would win in the competitive strategy of placing planes in the world market. I believe this is the important role of a CEO—to change attitudes and behaviors . . . So I would say that management is perhaps the magic word for the future. That's what the president asked for from Jorge Gerdau — a management shock to eliminate the distrust between government bureaucrats and the national productive sector.

What would be the best strategy for Brazil to defend against the heavy competition from Asia?

Be a better competitor than they are. Is that difficult? Extremely. Last year Brazil graduated just under 40,000 engineers. China graduated 630,000. If we imagine that just 10% of Chinese engineers are exceptionally talented, last year China graduated a larger number of talented engineers than Brazil graduated engineers of all talents. It's a huge loss of competitiveness, but also a great challenge, which can only be overcome by education.

Several decades ago, General Park Chung Hee and Deng Xiaoping launched the biggest educational programs their countries had seen. The Financial Times defined the Korea program as 'Bigotry for Education'. A month ago, in Detroit, the cradle of the American auto industry, a Korean car was voted Car of the Year.

Back to the case of Embraer, I am convinced that we are only able now to sell Brazilian aircraft to 90 countries because the company was

If we hand over to the private sector everything we can in terms of infrastructure, Brazil would change with extraordinary speed.

based on an educational process led by the Technological Institute of Aeronautics (ITA). In Brazil today, however, education seems not to be a priority . . . We should open the window of opportunity, correct this educational deficiency, and establish a program to beat the Asians. If they sell products worldwide, what can we do?

What the government does is crucial in determining whether Brazilian businesspeople manage efficiently.

Sell Brazilian products worldwide as well. That is the only way to stop them. We are a continental country with 200 million inhabitants and territorial, ethnic, and language unity. If China did it, we can do it even faster. Simply bring together government, the productive sector, and Brazilian society in the quest for global competitiveness. ■



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Rethinking the future of agriculture

Thais Thimoteo, São Paulo



In the last 30 years Brazil has become, behind only the European Union and the United States, the third largest exporter of such agricultural commodities as soybeans, sugar, orange juice, chicken, and beef, producing an agricultural trade surplus of about US$50 billion in 2010. That success is due not only to abundant natural resources but also to internationally recognized technology centers, with the Brazilian Agricultural Research Corporation (Embrapa) heading the list. Nevertheless, there is global concern about possible food shortages, given the demand created by 7 billion people today and an expected 9 billion by 2050.

According to the Organization for Economic Cooperation and Development (OECD), world food supply will need to increase 20% in 10 years to meet demand, and Brazil will need to contribute about two-fifths of that. That is why the Brazilian Institute of Economics (IBRE) and the Agribusiness Center of Getulio Vargas Foundation (GV Agro) presented the first Roundtable on the Agribusiness Scenario, on March 19 in São Paulo city.

Today

Despite its apparent success Brazilian agriculture must still deal with a variety of problems, from sanitary issues like foot and mouth disease (FMD) in cattle to structural problems like outdated rural labor legislation, poor access to credit, and unresolved environmental issues.

In his keynote address Roberto Rodrigues, former Minister of Agriculture and GV Agro coordinator, said, "Globally there is a

Photos: Eduardo Merege.

need to find a theme that will articulate humanity's demands. I argue that the theme should be food and energy security and sustainability." Today, he said, the world lacks leadership and strategy; because of its agribusiness success, Brazil is likely to become an important catalyst for pioneering projects: "Look at the numbers: planted area in Brazil grew almost 30% in the last 20 years but production increased nearly 180%—six times as much. In sugar cane farming, we have reduced CO2 emissions to 11%—an important contribution to reducing global warming."

> "Look at the numbers: planted area in Brazil grew almost 30% in the last 20 years but production increased nearly 180%—six times as much."
>
> Roberto Rodrigues

José Carlos Vaz, executive secretary, Ministry of Agriculture, Livestock and Supply (MAPA), acknowledged that Brazil still faces problems that ultimately might undermine its privileged position. He also questioned whether the current model of agribusiness development is too focused on economic factors and not enough on social factors: "This is a model that drives producers out of rural areas, that discourages the younger generations of rural families from remaining. Do we want to continue with a model focused only on global interests? Some say yes, arguing that as society modernizes we will not need so many people on farms. But do we want to be increasingly concentrated in urban areas?" He added that although the scenario for Brazilian agribusiness seems encouraging, "If you look closely there are small cracks, uncertainties." Only through democratic debate and collective empowerment, planning and strategy, he believes, will Brazil "achieve results that are fair, both socially and economically."



Roberto Rodrigues



José Carlos Vaz



Luiz Carlos Carvalho

Luiz Carlos Carvalho, president, Brazilian Agribusiness Association (ABAG), said that if agribusiness is to be more productive, "We need to set regulatory frameworks, focusing on sustainability, and encourage investment in research. No one is creating mechanisms and policies to do this."

> "One of the sore points [in the new Forest Code] is the permanent preservation areas (APPs)… How will the government remove thousands of people who have been producing crops in the APP regions for years?"
> Rodrigo Lima

Environmental considerations

Regulation matters. The new Forest Code "contains flaws that generate legal uncertainties and need to be reformed," said Rodrigo Lima, general manager, Institute for International Trade Negotiations (ICONE Brazil). "One of the sore points is the permanent preservation areas (APPs)… How will the government remove thousands of people who have been producing crops in the APP regions for years? … It is not enough to adopt a law and then push a button to make it implement itself. So, we will have to establish a policy line that certainly will displease both sides." Luiz Daniel Campos, representative, International Finance Corporation (IFC) of the World Bank, agreed with Lima about the need for greater legal certainty in the sector. However, he said, more relevant than the clash between the farmers and environmentalists about the Forest Code is a business concern with sustainability. "If we do not have a private sector investing prudently, being sustainable from a financial standpoint," Campos said, "it will not be worth investing in environmental issues, because companies will go bankrupt. … Responsible investment will be balanced between economic and environmental objectives."


Rodrigo Lima


Luiz Daniel de Campos


Werner Grau Neto

Lima and Campos agreed that much of the problem is political rather than technical: There need to be policies to help small farmers generate income or to assist in food distribution."Today," Lima said, "there are more forests than farmlands. Someone who does not have enough to eat will cut down to plant. No one will obey the law. There should be public policies for Indians, settlers, and loggers."

Werner Grau Neto, managing partner, Pinheiro Neto Advogados law firm, thinks that in putting forest conservation and agribusiness in opposition to each other, the Forest Code risks undermining agribusiness competitiveness. "Deforestation is a price we as a society have to decide whether or not to pay. However, the international community will use it to condemn our agricultural sector, as a way to pressure us," Neto said.

"Deforestation is a price we as a society have to decide whether or not to pay. However, the international community will use it to condemn our agricultural sector, as a way to pressure us."
Werner Grau Neto

Bottlenecks

A major deterrent to making agribusiness more productive is undoubtedly the lack of sound infrastructure and logistical efficiency. To Cesar Borges, executive director, Brazilian Association of Logistics, solutions like railway privatization are coming about too slowly. The reason, he said, is that "The ministries and government agencies [that deal with transportation] are in the hands of political parties. We are further penalized because the work stops when ministry and agency leadership changes," as when the director of the National Department of Transport Infrastructure (DNIT) resigned.


César Borges


José Torres de Melo


Herman Marx

"This is a sector that contributes 20% of GDP and accounts for 37% of jobs. In 2011, it exported US$95 billion, 37% of total exports. So, it is essential [for the government] to invest in ways to transport this production," said José Torres de Melo, vice president, National Confederation of Agriculture (CNA). The World Economic Forum ranked Brazil 104th in infrastructure last year—114th in quality of roads, 9th in railroads, and 130th in ports. "Brazil invested 1.8% of GDP in transport infrastructure in 1975 and only 0.4% in 2010. China invested 11% of its GDP on it in 2010, and India 8%. At Brazil's current low level of investment in infrastructure, it is impossible to maintain the level of exports," de Melo said. "In the North, Northeast and Midwest production is being halted because it has nowhere to flow."

"This is a sector that contributes 20% of GDP and accounts for 37% of jobs. In 2011, it exported US$95 billion, 37% of total exports. . . . At Brazil's current low level of investment in infrastructure, it is impossible to maintain the level of exports."
José Torres de Melo

Herman Marx, professor, School of Advertising and Marketing, agreed: "When you are not investing enough to maintain the existing transport network, we can see clearly that Brazilian infrastructure is degraded." He explained, for instance, that the problem with highways is paving, and "Of 1,400,000 unpaved roads, 94% belong to municipalities that do not have money to build roads. As for waterways, our cheapest transportation, we do not use even half of what we could today."

International trade

José Augusto de Castro, vice president, Association of Foreign Trade of Brazil (AEB),


José Augusto de Castro


Leila Harfuch


Marco Farani

pointed out that "There has been a change for the worse in Brazil's export composition. We are concentrating only on commodities. ... There must be a greater effort to diversify exports." He added that Brazil needs to take advantage of the huge market that is opening up, because emerging markets like China, India, and Russia have no new areas available for planting. "We can consolidate our position as the world's granary," he said, but he joined the chorus of previous speakers when he added, "We have to realize that we need to substantially improve our infrastructure."

> "Think tanks are urgently needed if we are to develop new paradigms, one of which is the green economy in which growth and sustainability are not antagonistic."
>
> Silvio Crestana

Leila Harfuch, ICONE Brazil, pointed out that since 2000 food prices have been increasingly volatile because of the imbalance between supply and demand, saying, "Demand for food is growing at rates higher than production capacity."

Technical cooperation with other countries to promote the development of agribusiness can raise Brazil global profile, suggested Marco Farani, director general, Brazilian Cooperation Agency (ABC), Ministry of Foreign Affairs. "Our job is to send Brazilian technicians to improve the knowledge of other developing countries," he said. "While it is an altruistic activity, non-profit in the short term, it is a way to be recognized and influential. We finance projects and we care for them." Farani's agency is currently cooperating on agribusiness projects in Africa with the Japan International Cooperation Agency (JICA). "The African savanna has vegetation similar to the Brazilian savanna," Farani explained, "and our partnership with Japan provides for transfer of Embrapa's knowledge and JICA funding for



Alexandre Mendonça de Barros



Edivaldo Del Grande



Christian Lohbauer

infrastructure. We hope to bring Brazilian and Japanese businessmen to see the project, to stimulate business opportunities."

Risks

The classic idea that small farms, even subsistence farms, were intended for the cultivation of different varieties of food in the same area is no longer accepted. Now, the trend is specialization. However, while that increases productivity, it also raises risks, in view of possible natural disasters and lack of credit facilities and farm insurance. Here, "cooperatives and associations have a key role in the survival of much dispersed agricultural structure, especially in the South. They allow for greater resilience to market volatility while providing the benefits of production scale," said Alexandre Mendonça de Barros, partner in consultant MBAgro. However, these groups often need better management. "We are very far from companies with clear governance, and solid structure," Barros said.

> "Although numerous credit lines are available, we risk ending the crop year 2011–12 with the lowest first-time lending in recent years because of the infernal bureaucracy required to obtain credit from the BNDES and a smaller number of private banks offering credit to farmers."
>
> Ademir Vian

In the beginning, Edivaldo Del Grande, president, Organization of Cooperatives of the State of São Paulo (OCESP), explained, "Old managers, often with little knowledge, did not give enough importance to administration… This portrait is changing as the second generation of managers, the sons of the former are more educated. The Program for Revitalization of Agricultural Production Cooperatives (Recoop) also contributed to investment in training, including training the managers themselves."

Christian Lohbauer, president, National Association of Exporters of Citrus (Citrus-BR), shared his experience and offered some suggestions: "Since the 1990s national associations have gained importance because out-of-date production structure could not cope with the demand. The entities were modernized and professionalized in only 15 years." But, he explained, with advances also came problems, such as difficulty in adopting a common agenda. "The farmer has a conflicting relationship with industry representatives; and without [transparency] it is difficult to reach a consensus vote on bylaws and budgets, because each company has its own," Lohbauer said. He also noted another problem: "There is a huge gap between what the private sector and farmers are willing to do themselves and the government's ability to respond to their demands."

How Brazil benefits from technological innovation

When multinationals came into the Brazilian agricultural sector, they brought with them technological innovations to boost productivity. One example is Monsanto, a major U.S. company that applies technology to agribusiness, manufactures herbicides, and produces genetically modified seeds. Intact Pro RR2—soybean seed with high value added now being tested by 500 soybean farmers in Brazil—is the company's first product released outside the U.S. Currently, the modification process is being approved by major markets for Brazilian soybeans. Rogério Andrade, Monsanto manager, says the seed protects the soybean from insect-caused injuries; makes it easier to control weeds (the seeds tolerate glyphosate, a strong herbicide); and produces higher yields. Andrade says that part of the US$1.4 billion Monsanto invests annually in technology is spent in Brazil.

The process by which Monsanto chose producers and tested the new type of soybean was meticulous. Farmers were selected in each region. Maize was cultivated between soybean plantings in order to separate the new varieties from older ones and observe differences in crop yields and other factors after harvest. Another breakthrough was the efficient use of the new seeds through accountable product management. "What remains after planting is entirely recycled," said Frederico Saraiva, field supervisor of the Intact Pro.



Rogério Andrade, Monsanto manager.

Modernization and innovation

Technology has driven many of the advances in Brazilian agribusiness in the four decades since Embrapa was established. With the development of new irrigation techniques and drought-resistant seeds, in the savanna grain production, especially of soybeans, has soared. However, science is still striving to cope with such issues as water scarcity, food quality, and the implications of biotechnology and bioenergy. For Mauro de Rezende Lopes, an IBRE specialist in agribusiness, the solution is better marketing: "Competition in the livestock market is largely responsible for investments in research today. Large companies … direct their research according to market demand, and this is an important strategy for us."

José Carlos de Freitas, director, Chamber for Agricultural Machines & Accessories (Abimaq), raised a concern that the national model of agriculture is too costly. He said,

"Soybeans, for example, are expensive to plant due to high prices of pesticides and the huge amounts of chemicals used. The profit margin is small. You gain only because of scale. Thus, the number of producers has been falling since the 1960s." He pointed out that "There are 3,000,000 families who do not have access to agricultural machines because there is no way for them to obtain National Bank for Economic and Social Development credit to modernize."

Embrapa researcher Silvio Crestana considered it essential to understand the geopolitics of food scarcity in order to use technology to increase productivity. Here, the Rio +20, United Nations Conference on Sustainable Development, in Rio de Janeiro on June 20–22, 2012, could be useful. "Think tanks are urgently needed if we are to develop new paradigms, one of which is the green economy in which growth and sustainability are not antagonistic," he said. "Integrated sustainable expansion in traditional areas—tillage, crop, and livestock integration, for example — could be a way to optimize productivity. It is already showing great results."

Protection and Credit

The agricultural credit system is, according to Ademir Vian, deputy director of products and financing, Brazilian Federation of Banks (Febraban), a "handful of overlapping credit standards" that do not meet the specific needs of agribusiness areas. He said that "Although numerous credit lines are available, we risk ending the crop year 2011–12 with the lowest first-time lending in recent years because of the infernal bureaucracy required to obtain credit from the BNDES and a smaller number of private banks offering credit to farmers. Our challenge is to find sources of funding—there is no point in having a modern machine in the field and no money to buy fuel."

Renato Buranello, managing partner, Demarest & Almeida law firm, pointed out that the lack of interaction between the various possibilities of credit for rural producers. "We have enough credit instruments for agribusiness," he says. "The question is how to put them into practice safely in ways that are economically viable." José Américo de Sá, adviser to the president, National Confederation of Insurance Companies (CNSeg), commented specifically on crop insurance, saying, "This is not a Brazilian invention. Everywhere else the market has succeeded this way: The private sector [creates insurance products] and the public sector takes care of subsidizing insurance premiums and ensures solvency for risks caused by nature. This can make insurance more attractive to farmers."

Latin America's turn?



Manuel Otero, IICA representative in Brazil.

The global boom in commodity prices since the 2008 crisis has stimulated Latin America's agribusiness sector. Imbalance between supply and demand, international economic uncertainties, and China's food imports have restructured world supply. For Latin America agricultural production prospects in 2011–2012 thus look promising. A survey by the Inter-American Institute for Cooperation on Agriculture (IICA) found that 70% of the representatives of agribusiness interviewed believe that performance will be even better this year than in 2010. However, Manuel Otero, IICA representative in Brazil, points out, "Rising food prices can be considered good news for exporters in Latin America, but they are a concern for importing countries, which means more than half the countries in Latin America."

For Brazil, the scenario can be advantageous because it reduces competition and helps to consolidate Brazil's international position in agriculture. "Today it would be inconceivable to think of an agricultural summit without Brazil. … In our continent, Argentina and Brazil have enormous opportunities to capitalize," Otero says.

However, to reach a truly positive result, it is essential that investment in research and development (R & D) rise. Latin America may be the world region that has most potential to expand its planted area (41%), but the IICA thinks it does not invest enough in R & D, especially compared to the United States and Canada, which each invest about 2.5% of GDP. Otero says that except for Brazil's Embrapa, "Latin America invests little in R & D. Latin America has no awareness of how science can contribute to the growth of agribusiness."

Another IICA survey found that producers think that public policy priorities in Latin America should first ensure the domestic market, then stabilize prices and promote production. Otero concludes that "We should think less about sectoral policies and more about agricultural policies—think about the responsibility of agriculture for food production, environment, and reduction of poverty in rural areas. Moreover, we must take a proactive stance and conclude the Doha Round so that we have the same trade rules for both agricultural and industrial goods."



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The persistent apathy of industry



Luiz Guilherme Schymura

The manufacturing sector has been complaining that it is losing competitiveness. With a fall in industrial production of 2.1% in January 2012 compared to December 2011, these complaints have gained strength. The reasons cited for the loss in competitiveness are appreciation of the Brazilian real, and the high "Brazil cost."

With regard to the exchange rate, the prospects are not favourable. As China continues to grow at about 8% per year, exports of Brazilian commodities are bound to rise. Meanwhile, the economic problems of Europe and America are likely to keep international liquidity high, which will lead to more inflows of foreign exchange. The increases in both commodities exports and inflows of foreign capital will continue to stimulate exchange rate appreciation. Since there is not much that can be done about that reason for lessened competitiveness, the focus of the analysis should be on the high "Brazil cost" and ways to reduce it. Is this indeed a reason for tangible concern about our manufactures?

The share of the manufacturing industry in GDP fell from 15.3% in 1996 to 14.0% in 2007 and then

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accelerated in the last four years, dropping to just 12.4% of GDP in 2011. However, while the drop in the participation of manufactures in the domestic economy cannot be disputed, international experience shows that as a country develops, manufacturing inevitably gives way to services.

What is striking in the case of Brazilian manufacturing is the persistent apathy that is reflected in the numbers. Industrial production in January 2012 was roughly the same as it was in December 2007. The country is growing, in other words, but manufacturing is not.

The leading indicators related to the Brazilian macroeconomy show no cause for major concern: average annual GDP growth is less vigorous than would be preferred—hardly more than 4%—but far from bleak. The trade balance has shown surpluses, and current account deficits are not high enough to be worrisome. Domestic interest rates, although high, are declining. Despite the size of the government, it has been able to maintain primary fiscal surpluses. Inflation, though above target, is still within the comfort zone.

When the economic situation is satisfactory but industry is not going so well, what should we do?

When we take into account the tremendous efforts Brazil had to make to industrialize, fears of rapid deindustrialization are understandable. For decades, governments of different political and ideological persuasions have taken action to encourage and promote domestic industry. Although the ways in which industrialization was conducted might be criticized, undeniably Brazil's manufacturers have been efficient and competitive in many areas. Our exports have become more diversified, so the country is less vulnerable to variation in the price of any single product. Growth in productivity was higher over time in manufacturing than in other sectors of the economy, and it has generated jobs for a skilled workforce.

Since industry is apathetic, the world economy is uncertain and bringing about devaluation is difficult, we should therefore move to address the "Brazil cost." Measures are needed to facilitate operation of domestic industry, but they should not hinder foreign competition. We must give priority to policies that reduce the production costs of Brazilian firms, as has been done with payroll tax relief for specific industries. Policies that raise barriers to entry for foreign competitors are not recommended because they promote inefficiency, which is then covered up by abusive pricing.

The Brazilian economy is recovering, but more slowly than expected. Low inflation, high unemployment and income growth are promoting recovery, but lack of dynamism in industry and an expected slowing down of purchases of durable goods will act as a brake.

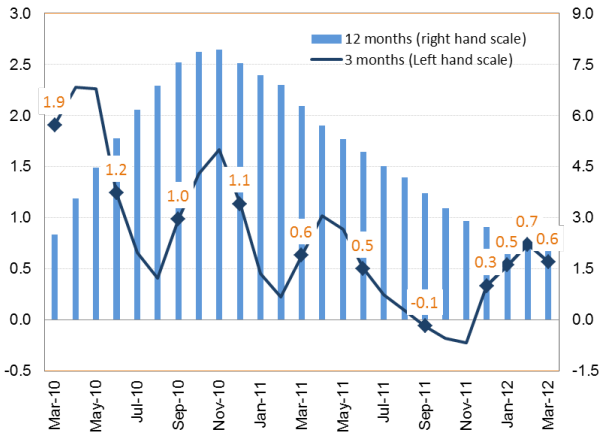
Brazil's economy has been recovering, thanks to retail, the construction industry, and financial services, which have been benefiting from credit expansion.

On the upside, low inflation in March brought 12-month inflation down to 5.24%. Unprecedentedly low unemployment and steady growth in incomes have boosted sales. The public budget posted very positive results in the first quarter and recent strength in revenues suggests that the primary budget surplus target for 2012 seems feasible. So far, Brazil's external accounts have not been much affected by slow growth in the U.S. and financial turmoil in Europe. Although growth in exports slowed, the trade balance in the first quarter was positive. Moreover, prices of major export commodities increased more than in the same quarter last year. For the remainder of the year Brazil's external outlook is moderately optimistic, and capital inflows should easily finance the current account deficit.

On the downside, the weak recovery of industrial activity in February and the results of an industry survey in March confirmed a lack of dynamism in manufacturing. Moreover, a slowing of purchases and rising defaults raise doubts that credit expansion will continue at the current pace. Finally, household consumption—which has been an important factor supporting domestic demand—should cool because household debt is increasing and a durable-goods buying cycle is ending.

IBRE Economic Activity Indicator, March 2010-March 2012

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



Sources: IBGE, and IBRE staff estimates.

Summing up, recovery in the second half is expected to be larger because manufacturing is anticipated to expand faster — there is (subdued) optimism about industrial activity based on the renewed government activism represented by the industrial policy measures announced recently.

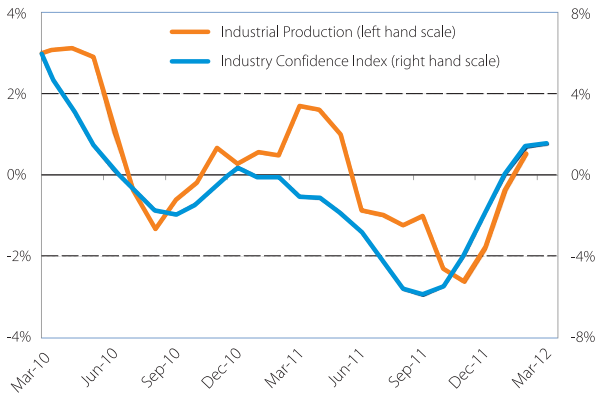
This optimism contrasts with concerns that the current benign outlook for inflation will reverse itself later in the year under pressure from increases in incomes and the minimum wage and their effects on demand for services, which is already overheated; this would force the central bank to raise interest rates, which would in turn curb economic recovery.

Short-term indicators

The recovery progresses, but slowly. The quarterly moving average of the IBRE Economic Activity Indicator, which anticipates GDP, reached 0.7% in February, and GDP is estimated to have increased by 0.6% in the first quarter. The IBRE industrial survey projects a modest recovery. But the indicator of planned production is virtually stagnant, despite a slight improvement in the Industry Confidence Index. Industry is estimated to have grown just 0.8% in March compared to 1.3% in February.

Industry's production and confidence index, March 2010-March 2012

(% change quarter-on-quarter)



Sources: IBGE, and IBRE industry surveys.