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The BRAZILIAN ECONOMY

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Foreign Policy

8 Protectionism has limits

New protectionist tariff hikes are driven mainly by administration concerns about the competitiveness of specific industries at a time when growth is lower than anticipated. But, João Augusto de Castro Neves explains, there are limits to how far protectionism can go as a policy driver in the long term.

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The government is calling on private initiative to unlock and carry out investments in transport infrastructure. But will it invest enough to bring transport costs down to keep Brazil exports competitive? Claudio Accioli and Solange Monteiro report on opinions expressed at a recent seminar that regulation of the transport sector still needs to be reformed to make the investment effective.

18 Urban transport has to be planned

In the 1950s 36% of Brazilians lived in large cities; today 85% do. The problem is that public transport has not caught up with population growth. Meanwhile, the government is promoting car sales, although it has also passed a law requiring municipalities to draw up mobility plans and is entering into public-private partnerships for infrastructure projects. Kalinka Iaquinto consults the experts on whether this will be enough to give public transport a higher priority.

Interview

22 Transport speeding up

Transport Minister Paulo Sérgio Passos, although not a member of the Workers Party, was appointed by President Rousseff to "put the house in order." Passos, who started his career at the ministry, recognizes that Brazil "lacks an infrastructure compatible with either its territorial extension or the complexity of the productive structure of the economy," and explains to Kalinka Iaquinto what the administration plans to do about the problem.

IBRE Economic Outlook

27 Economy speeds up, but investment outlook is worrisome

In the last four weeks, production and sales data as well as IBRE surveys have confirmed expectations of economic recovery, but despite the good news, some economic indicators remain stubbornly negative or mask uncertainties.

ECONOMY

Brazil's Central Bank orders Cruzeiro do Sul bank liquidation

In June Brazilian authorities seized Cruzeiro do Sul, a midsized bank specializing in payroll-deduction lending, after detecting accounting irregularities. Brazil's deposit guarantee fund (FGC) took over administration of the bank and has now issued a statement that it is recommending that the bank be liquidated after failing to find a buyer for it. (September 14)

Job growth slacks off

The Brazilian Labor Ministry reported that the economy created only 100,938 new jobs in August, down sharply from 142,496 in July. For January through August, Brazil created 1.4 million new jobs, down from 1.6 million for the same period in 2011. (September 20)

Consumer confidence rose in September

The Fundação Getúlio Vargas (FGV) Consumer Confidence Index rose 1.4% in September from the previous month, after falling 1% in August, because consumers have an improved view of the current and future prospects of the economy. (September 24)

Current account deficit and FDI down

The current account deficit was US$2.6 billion in August, down from US$4.8 billion a year earlier. Meanwhile, foreign direct investment fell to US$5 billion. While the current account has been stable with a moderate deficit of 2.0%–2.2% of GDP, there are concerns that it could be vulnerable to a change in investor sentiment toward Brazil. (September 26)

State-owned banks lead lending; defaults steady

Bank lending in Brazil rose in August as state-owned banks stepped up disbursements to help the government jump-start the economy. In September credit increased by 17.0% year-on-year, down from 17.7% in August. In contrast, private banks have drastically restricted loan origination as they reduce their portfolios in risky segments like auto financing. However, nonperforming loans to households held at 7.9% of total loans and to corporations increased marginally to 4.1%. (September 26)

Expansion of industrial production uneven

Industrial production in Brazil expanded in August at the fastest pace in 15 months thanks to heavy government stimulus, but reliance on a few sectors suggested a full recovery might still be far off. Output grew 1.5% in August from July, government statistics agency IBGE said, more than any month since May 2011. Capital goods, which had been hit heavily during the global crisis, gained 0.3% for the month — sluggish capital goods activity reinforces concerns that investment spending is still fragile. (October 2)

Inflation accelerates

Official inflation as measured by the IPCA price index accelerated to 0.57% in September, after the previous high of 0.41% in August, the government statistics agency IBGE said. The 12-month inflation rate hit 5.28%. Food accounted for more than half of the jump. (October 5)

LATIN AMERICA

ECLAC projections for growth adjusted downward

Latin America and the Caribbean will grow 3.2% this year, rather than the 3.7% previously estimated, due to downward adjustments for Brazil, the region's largest economy, and Argentina, said the Economic Commission for Latin America and the Caribbean (ECLAC). Its 2012 estimate for Brazil is 1.6% rather than the 2.7% projected last June. The main problem for the region is the weakness of the world economy. For 2013, the expectation is that Latin America and the Caribbean will grow 4%, which is also the estimate for both Brazil and Mexico. (October 2)

JUDICIARY

Former officials convicted on corruption charges

Brazil's Supreme Court convicted three top aides of former President Lula on charges of diverting public funds to buy political support for his coalition government when it came into power a decade ago. The court found Lula's former chief of staff José Dirceu, cofounder of the Worker's Party (PT), guilty of "running a scheme of monthly payments to politicians in exchange for their votes in Congress." The minimum sentence could be 18 years in jail. (October 9)

TRADE

Brazil-South Africa chicken row

South Africa's poultry industry is accusing Brazil of dumping chickens there, and farmers say they are forced to cut jobs because they cannot compete with Brazil's "unfairly low" prices. Denying the charge, Brazil has taken the matter to the World Trade Organization. South Africans eat more than a billion chickens a year, and last year close to 60% of all poultry imports came from Brazil—far more than any other country, according to official figures. (October 2)

FOREIGN POLICY



Photo: Jose Cruz/Agencia Brasil.

President Dilma Rousseff and Prime Minister Cameron.

Brazil and UK sign science and technology agreements

President Dilma Rousseff and British Prime Minister David Cameron signed three agreements related to science, technology, and innovation in Brasilia. The agreements call for an increase in the number of students sent to the United Kingdom through the Brazilian Science Without Borders program; cooperation between the BG Group, a world leader in natural gas, and Brazil's National Council of Scientific and Technological Development; and initiation of research projects related to oil and derivatives. (October 1)

ECONOMIC POLICY

Tombini: Brazil economy in gradual recovery

Central Bank Governor Alexandre Tombini said that inflation is under control and the Brazilian economy is gradually recovering, with industrial output showing signs of speeding up.Tombini told a Senate committee hearing that recent measures to stimulate the economy will help contain price pressures in the medium term and bring about more vigorous and sustainable growth. He said inflation might accelerate in the short term due to agricultural price shocks due to the U.S. drought, but would again decline over the long term. (September 12)



Photo: Wilson Dias/Agencia Brasil.

Central Bank Governor Alexandre Tombini

New round of tax relief to boost economy

To stimulate the economy in the face of global financial headwinds, Brazil has extended tax breaks to more than two dozen industries and reduced the cost of acquiring capital goods. Finance Minister Guido Mantega said the government was extending payroll tax breaks for 25 industries, including poultry and pork producers, wood pulp, and freight and passenger transportation. The tax breaks, to take effect in January 2013, will cost the government R$13 billion (US$6.41 billion) in forgone tax revenue. (September 13)

Central Bank cuts policy rate to 7.25%, signals end of easing

The Brazilian Central Bank cut its policy interest rate a quarter point, to a record low 7.25%, but signaled its 13-month easing cycle was ending. The central bank's rate-setting committee was divided, with five directors in favor of the cut and three against. (October 10)

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Is this really the way to go?

MINISTER OF TRANSPORT Paulo Sérgio Passos is convinced that "it takes the combination of a large modern infrastructure and efficient logistics to contribute to sustainable growth." He speaks with enthusiasm about how many kilometers of roadway are to be constructed under the new public-private partnership program, and what is planned for railways, ports, and airports. And to be sure, that is needed: the World Economic Forum gives Brazil abysmal ratings on infrastructure in its Global Competitiveness Index. Clearly the push to improve Brazil's infrastructure is vastly overdue.

But what Minister Passos doesn't mention is that this beautiful new infrastructure program will do little to lower transport costs in Brazil unless there's a way to get around the regulatory potholes the administration is still not ready to repair. At the recent roundtable on "Transport Infrastructure, Logistics and Urban Mobility in Brazil," for instance, one comment was that "government transport programs will only get good results if there are changes in how the licenses needed are issued."

This new infrastructure program will do little to lower transport costs in Brazil unless there's a way to get around the regulatory potholes the administration is still not ready to repair.

It may simplify the discussion if we look just at one mode of transportation—railroads—and if we look at how our powerful and productive neighbor in North America dealt with problems in that industry 30 years ago. The United States and Brazil have similar attributes in terms of size and geography. A high proportion, 60%, of its freight transport consists of bulk commodities, like coal or iron ore, over long distances. Because of the long distances, low air fares, and high car ownership in the U.S., rail is not competitive for transporting passengers but is ideal for freight. Intercity rail freight volume had fallen from 70% of the total in 1945 to 37% in 1980, and while most freight railways were privately owned, they were heavily regulated, with controlled rates. Returns on investment were plummeting.

In 1980 the U.S. Congress passed the Staggers Act, which was intended to achieve a balance between the financial viability of the railway industry and the interests of shippers by deregulating a substantial proportion of the rail freight industry. In the next 20 years:

- Labor productivity increased by a remarkable 262%.
- Average rates per ton/km declined for all commodities by an average of 55% in real terms.
- Traffic increased by 40%.
- Intermodal traffic grew by 184%.
- Train accidents and employee casualty rates declined by 70%.

As a 2001 OECD[1] study of a number of national rail systems made clear, "Liberalization is essential for efficient operation of the railways." The same report also said that the responsible U.S. Minister "identified ownership of infrastructure by the train operating companies as a key factor in the success of the American reforms."

Once Brazilian transport infrastructure is built by private companies, the federal government will still own it, and exercising the ownership responsibilities will again be Valec, which just last year resonated with allegations of corruption.

Today, 60% of Brazilian cargo still goes by road, partly as a result of various decisions by the states. This not only raises the shipping cost per ton, it raises pollution levels.

And for at least one mode of transportation, railroads, the old, strangling regulations will still be in place. State and federal policies again need to be coordinated. And until the Ministry of Transport and the rest of the administration are willing to look at the whole problem of transport in Brazil—not just the part that can be measured in how much money is being invested in how many km of rail or road—Brazilian companies will continue to lose competitive ground to more far-seeing countries.

[1] OECD, 2001, "Railway Reform: Regulation of Freight Transport Markets."

Protectionism with limits

João Augusto de Castro Neves, Washington D.C.

LAST MONTH THE GOVERNMENT announced a list of 100 products—mostly auto parts, furniture, plastics, steel, and pharmaceutical inputs—on which tariffs were being raised for the next year with the option to renew for an additional year. Average tariffs went from 12–14% to 25%. The hike should affect about 4% of the country's total imports (US$5 billion of US$130 billion total imports), but these figures are likely to go up: the government is considering adding another 100 products to the list in the next couple of weeks.

These protectionist measures are driven mainly by administration concerns about the competitiveness of specific industries at a time when growth is lower than anticipated. Earlier this year the government announced measures to benefit the local automotive industry through tax hikes on imported cars. Shortly thereafter Brasilia decided to review its automotive trade deal with Mexico, ultimately limiting auto imports from that country. In the telecom sector, international carriers have complained about import restrictions that will be brought about by stringent local content clauses in the 4G wireless airwave auction held in June.

Although it is unlikely that recent measures will be reversed even in the medium term, there are limits to how far protectionism can go as a policy driver in the longer term.

But although it is unlikely that these measures will be reversed even in the medium term, there are limits to how far protectionism can go as a policy driver in the longer term. Since one of President Rousseff's main policy goals is to keep interest rates at a lower equilibrium level for the rest of her term, it is reasonable to expect that the government will be responsive to any challenges that might arise from inflationary pressures and relax some import restrictions. So in a scenario where economic activity rebounds, with a possible impact on prices, the likelihood that the government would resort to other measures rather than having the central bank raise rates increases considerably. Certainly, in that case, a reversal of some protectionist measures would be high on the list of policy options. In fact, recent protectionist measures were accompanied by a mechanism to monitor domestic prices for these products. So any fluctuation in their prices could prompt the government to review some of the measures it has adopted.

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Another limit to the government's protectionist stance is the possibility of retaliation by important trade partners. With regard to the auto sector, the government was responsive to concerns that automakers had voiced. Earlier this month a new automotive regulatory framework (Inovar Auto) was announced that seeks to incentivize local production through tax reductions if automakers invest in research, higher local content, and fuel efficiency. In essence, to mitigate the risk of retaliation at the World Trade Organization, the administration altered benefits that were initially intended to limit imports by easing import restrictions for automakers that met certain requirements. Some automakers have already reacted positively by reaffirming previous investment plans.

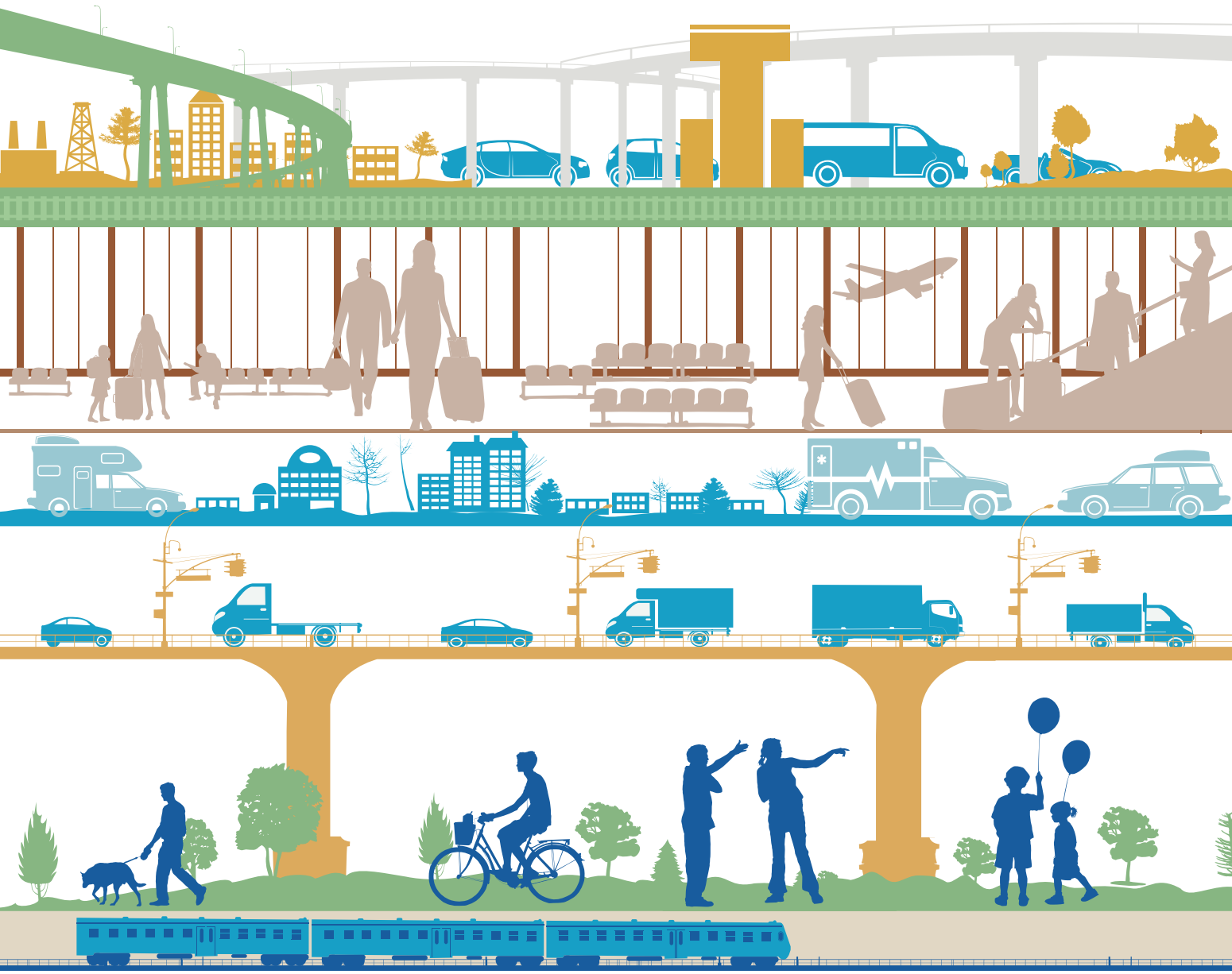
Moreover, much of the apparent proclivity for more protectionism has to do with the government's response to concerns voiced by powerful domestic industrial groups, as is the case with the auto sector. In the longer term, it is unlikely that a protectionist bias will arbitrarily encompass other sectors. Rather, these types of measures will continue to target specific sectors and be driven by industries that are able to voice their interests more intensely. Ultimately, the government will likely have to be pragmatic and try to walk the narrow line: protecting certain sectors yet attracting foreign investment and maintaining good relations with trade partners.

Finally, in the longer term, because the global economic slowdown negatively impacts Brazil's export sector and trade surplus, the government will be pressed to reconsider some aspects of its trade policy. In the last decade or so the failure of Brazil and Mercosur to negotiate major trade deals was overshadowed by high commodity prices and booming demand from China. Today less favorable winds are already affecting Brazil's exports. Through August the country's trade surplus was down by more than 30% year-to-date, from US$20 billion to roughly US$13 billion, and half of the loss is from just one partner, China. This will surely raise the importance of free-trade negotiations in the next few years.

Ultimately, the government will likely have to be pragmatic and try to walk the narrow line: protecting certain sectors yet attracting foreign investment and maintaining good relations with trade partners.

In fact, last month Brazil's foreign minister, Antonio Patriota, acknowledged that in a prolonged situation of low growth, the government, along with other Mercosur partners, will have to consider a more proactive, less defensive trade policy. The recent decision to open to public consultation Mercosur's talks with Canada and the European Union may be read as an incipient sign of this rising concern.

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Will the public-private partnership work?

The government calls on private initiative to unlock and carry out investments in transport infrastructure. But it has yet to reform regulation of the transport sector.

Claudio Accioli, *Rio de Janeiro*, and
Solange Monteiro, *São Paulo*

THE SECOND HALF of 2012 could mark a new phase for the transport sector in Brazil. With a program of concessions that seeks to attract the private sector to invest in construction and operation of roads, railways, ports, and airports, the Rousseff administration is giving a powerful boost to the economy. The program seeks to intensify the effort started with the Growth Acceleration Program (PAC) to eliminate bottlenecks in transportation infrastructure that undermine Brazil's competitiveness, but it can also help drive future growth. "The direct effect of these investments, divided over the next five years, represents 0.4% of GDP, but that does not count the indirect effects [on the economy]," said Transport Minister Paulo Sérgio Passos (see the interview on pp. 22). In late September in São Paulo a roundtable on "Transport Infrastructure, Logistics and Urban Mobility in Brazil," organized by the Brazilian Institute of Economics (IBRE) and *Conjuntura Econômica* magazine, attracted attention from both public and private partners.

The Global Competitiveness Index published by the World Economic Forum throws a harsh light on Brazil's infrastructure deficiencies. Paulo Resende, infrastructure consultant for the World Bank and professor of logistics and supply chains at the Dom Cabral Foundation, noted that among 144 countries "Brazil is ranked 135th in port facilities, 134th in the quality of its airports, and 123rd in roads. Investments in all transportation modes combined do not exceed 1.2% of GDP, while in other countries the average is 2.5%." Economist Claudio Frischtak of the InterB consultancy added, "We have seen that the capacity of the public sector to carry out investments in infrastructure is no more than 1%. When it tried to do more, the results were mismanagement and corruption. The PAC failed. Now it

"This is a window of opportunity that the international crisis has opened for Brazil to fix its infrastructure."

Marcelo Perrupato

is the turn of the private sector." But Fritschak argued that the government needs to institute more reforms to make the program succeed, saying, "We need changes in both the political and the regulatory plan."

Is that possible? Marcelo Perrupato, secretary of national transport policy of the Ministry of Transport, is sure that the answer is yes, but he recognizes that there is no time to waste. "This is a window of opportunity that the international crisis has opened for Brazil to fix its infrastructure," he said. "The National Logistics and Transport Plan is expected to invest R$430 billion by 2023; we have invested perhaps R$130 billion. We have 10 years to invest another R$300 billion—R$30 billion a year."

But to reach the 4% of GDP needed to modernize the country's infrastructure, Brazil would need to add about R$100 billion a year to what is currently invested, for a total of R$2.5 trillion over the next 25 years, according to consultants at Inter B. But for some sectors, the need for more competitive infrastructure is urgent. Luiz Henrique Baldez Teixeira, president of the National Association of Users of Freight Transport (Anut), explained that "High commodity prices in recent years have made up for the fact that shipping costs are not competitive, but that will not last forever. The steel industry, for instance, is going through a difficult time because there is excess supply globally, so producers have to be aggressive in price and quality." He added that "According to a study made with the Federation of Industries of the State of São Paulo, Brazil loses R$17 billion a year due to poor infrastructure. Transport users pay the bill."

LONG-TERM VISION

These concerns, however, do not overshadow the general optimism of businesses about the R$133 billion program for roads and railways announced in August, with a similar program for ports and airports likely to follow. "The model of concessions to private enterprise is correct [since] the government does not have capacity to operate the [transport] system," said Carlos Alberto Wanderley Nóbrega, a partner at DUX Consulting Transportation. "And mistakes made in the past model of granting concessions seem to have been corrected."

For analysts, creation of the state-owned Planning and Logistics Corporation (EPL) was a positive sign. For one thing, the EPL could help plan investments in multimodal integration to better balance the various types of transport. Today 60% of cargo goes by road, which considerably elevates the shipping cost per ton. Also, throughout the country tax incentives

Brazil's investment in infrastructure has declined

(percent of GDP)

2007	1.9
2008	2.5
2009	2.5
2010	2.4
2011	2.1
2012*	2.0

Source: InterB. * Estimate.

to promote industry have created transportation problems. Companies site new plants based on tax incentives, and "this has resulted in no railroad where there was a port, no port where there was industry, industry where there were no raw materials, and often no markets," said Fernando Simões, president of logistics company JSL.

Ricardo Molitzas, director of Logistics Operations Santos Brazil, agreed that the lack of planning results in both economic and environmental losses. He gave the example of the locks at Tucuruí dam, which took 30 years to complete and cost R$1.6 billion because a small supplementary project was not completed that would make 600 km of the river navigable. "How many trucks could that replace?" Molitzas asked.

The EPL can also help to put in place a long-term strategy. At the seminar Bernardo Figueiredo, EPL president and formerly on the technical staff of the National Transportation Agency, stressed the need to create a new dynamic in the transport sector with planning and continuous contracting of projects and works. He pointed out that it takes two years to do project design, licensing, and bidding before construction can begin. Tarcisio de Freitas Gomes, executive director, National Department of Transport Infrastructure (DNIT), said that municipalities have to change their practice of contracting works, which can be reduced from about 240 days to about 60 or even 45 days.

CONCERNS FOR THE BIDDERS

In a more stable economic environment, with Brazil's interest rates and country risk far below what they were 15 years ago, candidates for concessions now must charge less for their services than was possible for concessions granted in the 1990s, so gains in productivity and scale become more important. "The internal rate of return of projects in the transport sector has declined from 20% in 1995 to 1997 to 7% to 8% today," economist Fernando Camargo, partner of LCA Consultores, pointed out.

The new program of concessions

R$133 billion in 30 years

ROADS	RAILWAYS
7,500 Km	10,000 Km
R$42 billion	R$91 billion
R$23.5 billion in the first 5 years	R$56 billion in the first 5 years

Source: Federal government.

"Brazil loses R$17 billion a year due to poor infrastructure. Transport users pay the bill."

Luiz Henrique Baldez Teixeira

So far, companies concerned with logistics have used a number of strategies to grow, such as acquiring other companies or diversifying. For instance, in 2013 Odebrecht Transport, which owns concessions for Bandeiras road in São Paulo state, and the North Coast in Bahia state, expects to open the Embraport, a multipurpose terminal in Santos, which should surpass all other Latin American ports in movement of containers. But Paulo Cesena, Odebrecht chief executive, said of the government's new initiative that "What strikes me in this program is the complexity and urgency that the partnership calls for. There are projects that need to be detailed in technical and financial terms, taking into account contractual and legal aspects. You cannot do this without dialogue." His opinion was shared by Ricardo Castanheira, vice chairman of CCR, which manages both the President Dutra Highway, which connects São Paulo and Rio de Janeiro cities, and airports in Quito, Ecuador, and San José, Costa Rica,. "We must seek improvements to what is already in place without trying to invent the wheel. If we are unsuccessful, we will all lose."

Gustavo Nunes da Silva Rocha, president of Invepar, which won the bid to manage and operate Guarulhos Airport in São Paulo city in consortium with the South African company Acsa, believes that government programs will only get good results if there are changes in how the licenses needed are issued. The current system creates obstacles and raises the risks for private investors from lengthy deliberations at the Court of Audit, delays in environmental permits, and problems with expropriation of land.

REGULATORY RATIONALITY?

Traders and analysts are anxious to know whether the dose of rationality promised by the government will be equivalent for each mode. Carlos Alberto Nóbrega of DUX Consulting said, "For railroads, the separation between provision and operation of infrastructure will undoubtedly stimulate much needed investment and a more competitive business operation." But the big question is whether it will be possible to reorganize Valec, the state-owned enterprise that operates the railways, which last year was subject to allegations of corruption and which will responsible for selling rail freight capacity. Figueiredo of the EPL says, "The work that we want Valec to do is simple: sell railway shipping at a set price, providing free access to the market. A guarantee to purchase all freight capacity creates the best price for use." Manoel de Andrade e Silva Reis, coordinator of the FGV Center of Excellence in Logistics and Supply Chains, has some concerns

because "the history of the government managing railways has not been good." But he believes Brazil "will be different five years from now."

In terms of roads, investments in improvements should be accompanied by new regulations that diminish distortions in the freight market. Recent legislation establishing the workload of drivers and requiring payment by check or freight-card are advances that, analysts say, will increase the costs of freight and will balance demand. "Today, this industry is poorly regulated. The average age of the national fleet exceeds 17 years and drivers do excessively long journeys. The ease of entering this market has caused excess supply, which encourages the use of trucks over large distances," says Neuto G. Reis, executive technical director, NTC & Logistics. Trucks are more cost-effective for distances of less than 300 km; railways and water are better for longer distances.

While regulation of road transport is too weak, for airports and port facilities the weight of regulation inhibits competition. "To invest in new terminals applicants must prove that their own cargo makes the project viable, which dissuades private investors from taking the initiative to build a new terminal and sell space in it," Carlos Campos Neto, coordinator of the Infrastructure Economic Institute of Applied Economic Research (IPEA), said, adding, "Another thing that strangles investment is the legal uncertainty regarding the 98 port terminals with concession contracts due or ending in 2013. These are terminals through which more than 50% of all cargoes are handled. It is estimated that the uncertainty about the future of these terminals has frozen about R$10 billion in investments."

Traders and analysts are anxious to know whether the dose of rationality promised by the government will be equal for each mode.

"The internal rate of return of projects in the transport sector has declined from 20% in 1995 to 1997 to 7% to 8% today."

Fernando Camargo

"We also hope that the government programs are not limited to ports," added FGV's Neuto Reis. "Waterways are more important for transporting commodities." Molitzas of Santos Brazil also advocates the creation of a competitive environment for coastal navigation. "Most of Brazil's economic activity happens at a range of 200 km from the coastline," he said. Noting that only ships under Brazil's flag can do coastal navigation, he pointed out that the national coastal fleet is very small.

"Mistakes made in the past model of granting concessions seem to have been corrected."

Carlos Alberto Wanderley Nóbrega

FINANCING

The EPL's Figueiredo admitted that "We have an aggressive schedule for an aggressive investment program. But let's create a control process, launch a website to give transparency to actions taken, and that will help make the program more efficient." But, he said, one essential step has already been taken: "In 2003, when we began to discuss the railway issue, the Ministry had only a R$2.5 billion budget . . . . The PAC changed all that."

However, many experts question how the government has chosen to fund this new transport program. Armando Castelar, IBRE / FGV coordinator of applied economics, pointed out a problem with the government offer to fund up to 80% of road and railway projects at low interest. The private sector, he said, "will not be interested in funding [projects] at the same rates." He also thinks the National Bank for Economic and Social Development (BNDES) will find it difficult to securitize and sell the loans for these projects.

The president of BNDES, Luciano Coutinho, declared the bank wants to help issue infrastructure bonds, which were created in 2010, but the prevailing view is to rely on BNDES loans to finance the road and railway program, even if it means more contributions from the Treasury. Zurli Roberto Machado, BNDES director of Infrastructure, Basic Petrochemicals and Project Structuring, conceded that BNDES funding of infrastructure projects inhibits funding by private capital, but he believes that the bank's presence was necessary to ensure that investments were made even in an adverse economic environment, with interest rates high and domestic financial institutions reluctant to provide long-term financing.

Machado pointed out that, although the energy sector leads in BNDES disbursements, the areas of transport and logistics have grown most rapidly: from R$4.7 billion in 2011 to R$6.6 billion in 2012, of which R$2.4 billion went to railways. He said that in future the BNDES will evolve: "In addition to being the provider of long-term financing to the infrastructure sector, the bank will become the catalyst of private sector resources. The BNDES share in financing will certainly decrease."

The entrepreneurs who invest in the transport sector advocate less reliance on the BNDES and further development of capital markets. Gustavo Rocha pointed out that "Invepar was granted a concession in Peru for which it issued US$500 million 15-year bonds in the private market to finance the project. Brazil needs to look into that." Perhaps, as Castelar suggested, "The best alternative is to give these projects return rates and financing terms compatible with the Brazilian reality." ■



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Urban transport has to be planned

Kalinka Iaquinto, *Rio de Janeiro*

SPENDING HOURS STUCK in traffic, in cars or overcrowded buses, is routine for thousands of Brazilians, especially those who live in big cities. The problem is that public transport has not caught up with population growth. In the 1950s 36% of Brazilians lived in large cities; today 85% do. Meanwhile, the country has invested heavily in building up the automobile industry, and Brazil's economic growth, the rising incomes of its people, and more access to credit increased car sales.

Now it's time to take a fresh look at cities, prioritizing public transit and other means of transport, such as bicycles, to change the way Brazilians look at the use of cars.

According to a survey by the National Association of Public Transport (ANTP), between 2003 and 2010 the population of Brazil grew 13%—but the number of vehicles increased by 66%. "It is essential to take public transport out of the traffic jam by means of exclusive bus lanes," said Renato Boareto, coordinator of urban transport for the Institute for Energy and Environment (IEMA). Otávio Cunha, president of the National Association of Urban Transport (NTU), agreed, saying "About 10% of all trips made by car today will move to public transportation once the service offered is regular, efficient, and reliable. "

Awareness

These experts are not, they emphasized, suggesting that the purchase or use of private cars be abandoned or restricted. They believe that better public transport services will raise awareness that private vehicles should be used only for specific situations. Urban traffic planning must consider economic, social, and environmental as well as structural factors. "We cannot assume that everyone will have a car and that use is unrestricted. This could create a motorized inequality in which anyone who has a car has access to the opportunities for work, study, and leisure that the city offers, and those who depend on public transportation do not," Boareto warned.

The government recognizes the problems, said Alexandre Cordeiro Macedo, executive secretary of the Ministry of Cities. "The federal government is investing in changing the public transport system because it believes that the current model is broken." The country is currently carrying out its largest-ever program of federal investments in urban public transportation. In part, the impulse comes from the needs for the World Cup in 2014 and the Olympics in 2016. "The authorities are investing in public transportation in cities hosting the sport events, which will cost R$100 billion through 2016," said Conrado Grava, director of the National Association of Rail Passenger Transporters (ANPTrilhos).

"The World Cup and the Olympics were an excuse to leave a legacy to the people. Today, urban transportation is one of the top five national problems, along with health, education, housing, and security," said Julio Eduardo dos Santos, National Secretary of Transport and Urban Mobility in the Ministry of Cities. He said the government's intention is to solve more than one problem with its investments. Combining mobility policies with housing and sanitation is one of the criteria required for federal lending to municipalities.

Another development is the National Policy of Urban Mobility, which went into effect in April (Law 12.587/12). The law provides that all municipalities with over 20,000 inhabitants must draw up mobility plans. The goal is to get cities to think hard about their future growth. "The shortcomings of today exist because problems were resolved only case by case," said Cunha of the NTU. "Now the law requires an urban master plan if the municipality wants to access federal resources." However, said Lincoln Paiva, president of Green Mobility, "It's an improvement, but I do not believe that smaller towns can do this because they do not have the resources."

Public transport has not caught up with population growth: In the 1950s 36% of Brazilians lived in large cities; today 85% do.

Partnerships

In addition to federal resources, the government has expanded the participation of the private sector so that public works are completed faster. But, said José Mascarenhas, vice president of the National Confederation of Industry (CNI), "It's a first step, but there is not enough return on public transportation for private concessions. But public-private partnerships [PPPs] may work."

PPPs in other areas and in other countries have been viable and profitable for both entrepreneurs and governments, Cunha said: "The PPP is an interesting alternative in the urban transport sector. Entrepreneurs are aware that it is a good deal. For municipal governments it is also a good deal because they do not have

capacity to borrow for these investments but they do have the capacity to pay to amortize the investment over time."

The Institute of Applied Economic Research has found that Brazilians use buses most. But other modes of transport, such as metro rail, light rail trains, and railroads can be attractive alternatives because they transport more people faster and are less polluting. These alternatives, combined with government incentives to promote new forms of transportation to replace both cars and buses, would reduce the number of vehicles, the delays, the general discomfort of traffic jams, and greenhouse gas emissions.

Combining mobility policies with housing and sanitation is one of the criteria required for federal programs for lending to municipalities.

Reduction

However, in practice adopting rail systems would not eliminate buses, which currently carry about 60 million passengers per day, accounting for 90% of public transportation. The country is building 1,272 km of exclusive bus lanes in 25 large and medium cities. With a reduction in their payroll taxes by 2% of sales, bus companies will reduce their costs by R$1.1 billion a year. And by waiving R$1.1 billion a year, Cunha explained, the government expects to increase production by R$2.3 billion. This, he said, will boost the economy and create jobs.

In addition to setting off exclusive bus lanes, many municipalities are also moving to larger buses with cleaner engines. This alternative is cheaper and quicker to carry out than, for example, metro rail.

However, there is no single best choice for urban transportation. Each case is unique. As Boareto said, "The type of transport must be appropriate to the demand. You cannot propose a metro rail to take 10,000 people every hour per direction, or propose a bus corridor to carry 60,000 people every hour per direction."

The solution is neither easy nor quick. "It will take time," said Ailton Brasiliense, president of the National Association of Public Transport (ANTP). "We have been doing things the wrong way for hundreds of years, but with planning we begin to have some perspective on a solution. The current model is expensive, polluting, and generates too many accidents."

How Brazilians move around the cities, 2009

Tye of transport	Percent of total
Buses	25.9
Trains	3.6
Auto	27.0
Moto	3.0
Bikes	3.1
Walking	37.5
Total	100.0

Source: National Association of Public Transportation (ANTP).

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Transport speeding up



Paulo Sérgio Passos

Minister of Transports

Kalinka Iaquinto, *Brasilia*

TRANSPORT MINISTER Paulo Sérgio Passos is recognized as a specialist who knows his area well; he was appointed by President Rousseff to "put the house in order." Although he is affiliated with the Republic Party (PR), he gives assurance that when he acts he is motivated not by partisan interests but only by what is best for the government. He estimates that Brazil has to recover from about two decades of stagnation in investments in transport infrastructure. He argues for combining the Growth Acceleration Program (PAC) and the National Plan of Logistics and Transport (PNLT) to promote economic and social development by expanding, improving, and integrating different transport modes through investments in logistics.

***The Brazilian Economy*—Brazil has poor infrastructure to support economic growth. What are the government's immediate priorities?**

Paulo Sérgio Passos—Brazil in fact lacks an infrastructure compatible with either its territorial extension or the complexity of the productive structure of the economy. Countries that have developed followed a common path: they invested heavily in education, worked hard to promote technology and innovation, and have graduated in terms of infrastructure — transport, energy, and telecommunications. The sustained growth of the Brazilian economy has as one of its premises the organization of a modern transport system superior to what we have today . . . . It takes the combination of a large modern infrastructure and efficient logistics to contribute to sustainable growth.

Are we on the right path with the Growth Acceleration Program (PAC)?

After more than 20 years when very little was invested in transport, the country must find room in its fiscal planning to make significant investments in various modes of transport, and these investments are well reflected in the PAC. We have investments for extending highways, like BR-101 in the South and in the Northeast; large investments in construc-

tion and paving of highways, like BR-364 in Acre, Mato Grosso, and Minas Gerais states and BR-163 in Pará state . . . . Today, we are working continuously on more than 50,000 km of federal highways, most of which are transport corridors that move large volumes of cargo. We now have a road network that is well maintained, in which we are continuously investing, and this is an important aspect of the PAC.

How about railways?

Within the PAC, we can mention the North-South Railway. Previous governments completed only 215 km of railways. . . . Yet within two or three years we will have a railway that could allow us to link Santos port in São Paulo state to the Itaqui port in Maranhão state in the north. The government has also built in the state of Bahia a railway that extends from the grain-producing area in the west of the state to the seaside in Aritaguá, near Ilheus city. The government is also working with Transnordestina Logistics to advance work on the 1,728-kilometer highway from Eliseu Martins in Piauí state, the center of a grain-producing area, to the ports of Suape in Pernambuco state and Pecém in Ceará state. The PAC has allowed for a series of actions not only for roads and railways but also for waterways and ports.

What is the role of the private sector?

Government alone does not have the capacity to meet all the demands. We believe that government partnering with the private sector is appropriate, necessary, and has great strategic value. Based on the need to attract the private sector for important investments, the government presented to the public its program in logistics and transportation, focusing on roads and railways. The government will grant concessions for 7,500 km of roads and open up bidding for building 10,000 km of railways. The idea is that we need to accelerate implementation of these projects. Doing it with private enterprise is a good way to ensure that these investments can take place more rapidly.

Is there progress in the National Plan of Logistics and Transport ?

The roads chosen are those that today have high traffic flow. We are working on adding lanes to highway BR-101 in Bahia . . . so that in the medium term, we will be able to travel from Natal city in the north to Porto Alegre in the south. We are also adding lanes to highway BR-262 in Minas Gerais, Espírito Santo, and Mato Grosso do Sul states — a highway of great importance. We can also mention highway BR-153, the Belém-Brasília, which will be upgraded from Goiânia city in Goias state to Las Palmas city in Tocantins state, and highway BR-050, which will go from Uberlândia city in Mato Grosso to Goiás state. Another project will enhance highway BR-163 in Mato Grosso and Mato Grosso do Sul states . . . . These projects will transform Brazil's road infrastructure. Until recently

Brazil lacks infrastructure compatible with either its territorial extension or the complexity of the productive structure of the economy.

we had granted concessions for only about 5,100 km of federal highways. With the new program, we will grant concessions for 7,500 km, of which 5,700 km will be built by private concessionaires within five years of the signing of contracts.

The sustained growth of the Brazilian economy has as one of its premises the organization of a modern transport system that is superior to what we have today.

Why were concessions used for roads and public-private partnerships for railways?

The government uses concessions for roads and PPPs for railways because investments for each type of transport have distinct characteristics. We have no doubt that for road concessions the actual fee charged to users will finance the investment and maintenance of roads during the 25 years of the concession. Railways are different. We believe that investment [in railways] is absolutely strategic and very important for Brazil, but at the same time we need to find a smart way to feasibly construct 10,000 km of railways. We concluded that the best way was to separate the activity of building and maintaining the railways from their operation. Thus, the government first will solicit bids to choose construction companies to build and maintain the railways. . . . For this the winning bidder will receive rent payments for 30 years. The builder will not have risks in terms of demand [for railway transport], it may only have some engineering risk. Once the railway is ready, the government, through the state-owned enterprise Valec, will sell rail transport services to the private sector.

Is the funding sufficient?

The R$133 billion (US$67 billion) for roads and railways involves not only the investments needed to build 5,700 km of highways and 10,000 km of railways but also what will be spent over the years for their maintenance. Of course, we are conducting more detailed studies. These studies, which will be completed early next year, will show more accurately how much we will need to invest.

In recent years the participation of the National Bank for Economic and Social Development (BNDES) in private investment has grown significantly. How can we stimulate private capital to invest in transport?

For each of these projects the government will count on the BNDES to provide the necessary support by offering favorable financing conditions to the private sector. Today, the private sector can issue debentures with tax incentives to fund transportation projects. . . . We have the possibility of . . . attracting foreign capital, so we have a range of options to consider.

Do you think that the low rate of return could derail these private investments?

We understand that the country we live in has changed. Brazil is a stable country, a country that today offers much more secure conditions, and thus can offer lower rates

of return than those of 15 or 20 years ago. However, we need to combine the rate of return that the government is offering with access to financing. In the case of roads, we offer low interest rates, a 30-year grace period, a 20-year amortization period, and the possibility of financing 65% to 80% of the project value. The same applies to railroads.

Government alone does not have the capacity to meet all the demands. We believe that government partnership with the private sector is appropriate, necessary, and has great strategic value.

When will these actions affect the economy's growth?

The direct effect of such investments over the next five years is 0.4% of GDP. But there are also indirect effects .... When we build large stretches of highway, it stimulates private investment. . . . We want an increase in the supply of transport at a more competitive cost. The goal is to make Brazil converge toward the best international standards in terms of logistics and transportation.

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Daniela Medeiros,
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Economy speeds up, but investment outlook is worrisome

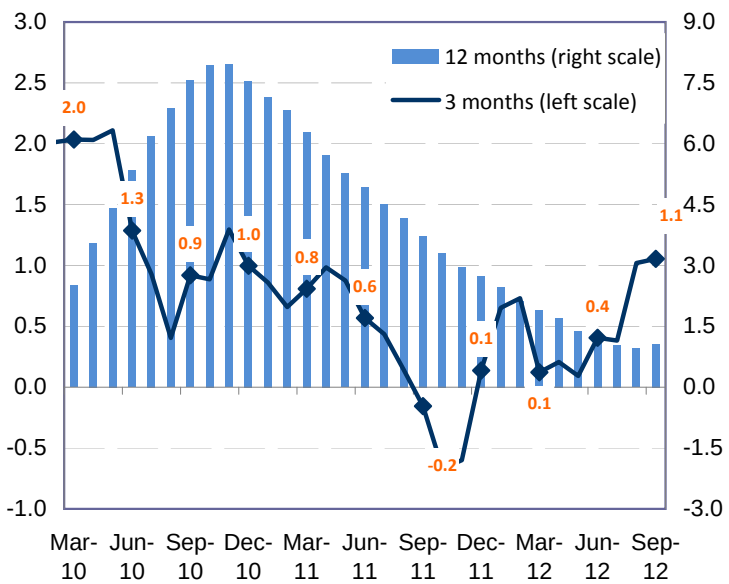
IN THE LAST FOUR WEEKS, production and sales data as well as IBRE surveys have confirmed expectations of economic recovery. Economic growth in the third quarter is very likely to be better than in the second quarter, due largely to the performance of the manufacturing sector in July and August. IBRE economic activity indicators in September confirm the acceleration of the third quarter, and the estimate is for seasonally adjusted GDP growth just above 1% compared with the previous quarter.

Despite the good news, some economic indicators remain stubbornly negative or mask uncertainties. After the progress made up to August, manufacturing production was not encouraging in September. IBRE surveys still suggest that the outlook for the production of capital goods is not very favorable. Because the external outlook is still undefined, international trade growth has been revised downward, which also negatively affects prospects for gross investment.

Also, although confidence in the durable goods manufacturing sector has improved, it may not be able to repeat third-quarter performance in the fourth quarter, partly because consumers anticipated their purchases on the expectation that the tax credit on durable goods would end in August. In September, indicators of demand for credit seem to have weakened and nonperforming loans are high because household indebtedness is high. All this is slowing sales of durable goods. The outlook suggests that investment will again be sluggish in the third quarter. The economy's recovery in the second half of 2012 was very dependent on consumption. Recovery of gross investment, which is essential for sustainable growth, is not likely to happen until the fourth quarter of 2012 at the earliest and more probably not until 2013. If investment does not recover, a third year of slow growth is not implausible.

IBRE Economic Activity Indicator, March 2010 - September 2012*

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



* Preliminary data Sources: IBGE and IBRE staff.

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