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INTERVIEW
Walter Russell Mead and Josef Joffe: Surprising foreign policy continuity under Obama

BUILDING FOR A MORE COMPETITIVE BRAZIL

Politics Where is the opposition?
Viewpoint The benefits and costs of presidential beliefs
Public policy Brazil's dysfunctional tax system
Seminar Energy debate heats up

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THE BRAZILIAN ECONOMY







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Leaders of the Party of Brazilian Social Democracy (PSDB) are too busy fighting among themselves to craft a message that will appeal to voters. Two stalwarts of the second main opposition force, the right-of-center Democrats (DEM), are leaving to form their own party. Yet there is an opening for an effective opposition, João Augusto de Castro Neves argues. Might it be the Greens?

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If all the projections for investments in infrastructure and the growth of the Brazilian economy are to come true, one expert says, by 2030 power generation in Brazil will have to double. Solange Monteiro, Kalinka Iaquinta, and Thais Thimoteo report on an energy policy seminar sponsored by the Getulio Vargas Foundation and Conjuntura Econômica magazine that covered prospects for the entire spectrum of Brazil's energy mix and offered guidance for public policy.

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Fernando de Holanda Barbosa explains how the principal-agent theory should apply to governance of Brazil's state enterprises, pension funds, and the State Guarantee Fund for Length of Service, and what has in fact been happening.

POLITICS

Democrats party (DEM) tries to contain internal dissent

The DEM elected Senator Jose Agripino Maia as its new president in its national convention, trying to rein in internal dissent. São Paulo Mayor Gilberto Kassab and the Deputy Governor of São Paulo Guilherme Afif Domingos left the DEM to found the Social Democratic Party (PSD). (March 15, 2011)

Opposition senator lashes out at the president

In his first speech in the Senate, Aécio Neves (PSDB-MG) criticized President Rousseff for not "breaking with the old." Although the former governor of Minas Gerais praised the government's social policies, he said the country needs a "reality shock" to deal with a Lula legacy of fiscal disorder, the risk of deindustrialization, and the threat of inflation. As expected, Neves stressed the need for reduce taxes to improve the economy. (April 6)

Supreme Court overturns use of the Clean Sheet Law for 2010 elections

The Clean Sheet Law (Ficha Limpa), which grew out of a popular initiative signed by 1.9 million Brazilians, would prevent politicians convicted in court from standing for election. The law was passed in May 2010, and the Supreme Court ruled retroactively that it did not apply to the November 2010 elections. The Court may rule on its constitutionality in time for the 2012 elections. (March 23)

FOREIGN POLICY

"For the people of Brazil, the future has arrived"



Foto: José Cruz/Agencia Brasil.

Presidents Barack Obama and Dilma Rousseff.

U.S. President Barack Obama made his first visit to Brazil in March; it came after a period of cooling between the two countries, marked by differing positions in President Lula's last two years on issues like Iran's nuclear program. In his well-received speech, Obama recognized Brazil as not only a regional leader but also a global power. He seemed to recognize that Brazil should no longer be understood exclusively as just part of a fuzzy U.S. agenda for Latin America. While many countries in the region see the United States as a source of financial resources and military assistance, Brazil has concerns about American presence in the region. What Brazil wants most from the U.S. is more balanced trade. (March 20)

Brazil votes for a UN special rapporteur on Iran

Changing its position, Brazil voted for a resolution of the UN Human Rights Council, proposed by the United States, to investigate violations by the Iranian government. The council approved appointment of a special rapporteur. (March 24)

ECONOMY

Official numbers better than consensus estimates

In January retail sales grew by 8.3% year-on-year in January, above the predicted 8.0%, and in February 281,000 new jobs were created — 195,000 had been expected. Meanwhile, bank offerings of mortgage-backed bonds have risen almost six-fold. (March 16)

Industry confidence falls again in March

The Industry Confidence Index (ICI) fell 0.1% in March compared to February, the Getulio Vargas Foundation reported. This is the third consecutive drop of the ICI, which reached its lowest level since November 2009. (March 31)

Rating agency ups Brazil's credit rating

Fitch has upgraded Brazil's bond rating from BBB– to BBB, citing greater fiscal restraint by the administration and the country's strong growth prospects. Moody's and S&P rate Brazil one notch lower. Brazil is still eight levels below Fitch's maximum AAA. (March 4)

Foreign capital inflows continue to be encouraging

Net foreign exchange inflows for March surged to US$12.7 billion, 50% of the inflows for all of 2010. Net financial inflows were US$9 billion and commercial inflows US$3.7 billion. (Central Bank, March 4)

Inflation speeds up again in April

In the first week of April, following major increases in food and transportation prices, inflation rose to 0.9%, from 0.7% in the previous week and 0.6% one month earlier; the prediction had been an 0.7% rise. (April 7)

BUSINESS

Government pressures Vale

In a meeting with Lázaro Brandão, chairman of the board of directors of Bradesco, a major shareholder in the Vale mining corporation, the government asked that Vale CEO Roger Agnelli be fired. Although Vale was privatized in 1997, the National Bank for Economic and Social Development and several state pension funds are also major Vale shareholders. Reportedly the government wants someone in the job who is more willing to follow its agenda. (March 21)

ECONOMIC POLICY

President: Fight inflation with growth

At a ceremony in Uberaba (MG), President Rousseff stated that it is possible to curb inflation without halting economic development and causing employment to drop. The ideal path, she said, is to increase the supply of goods and services. She was in Uberaba (MG) for the signing of a protocol establishing a fertilizer factory and a pipeline in the city. (March 27)

Central Bank governor: Curb inflation by containing demand



Photo: Antonio Cruz/Agencia Brasil

Central Bank Governor Alexandre Tombini

Central Bank Governor Alexander Tombini told a public hearing of the Senate Committee on Economic Affairs that to curb inflationary pressures it is necessary to slow domestic demand. He noted that most of the wage negotiations have been well above inflation, which puts pressure on prices. A combination of interest rate increases, fiscal reductions, and curbs on consumer lending, he said, would drive CPI inflation down toward the central bank 2011 target of 4.5%. (March 22)

Brazil acts to rein in exchange rate appreciation

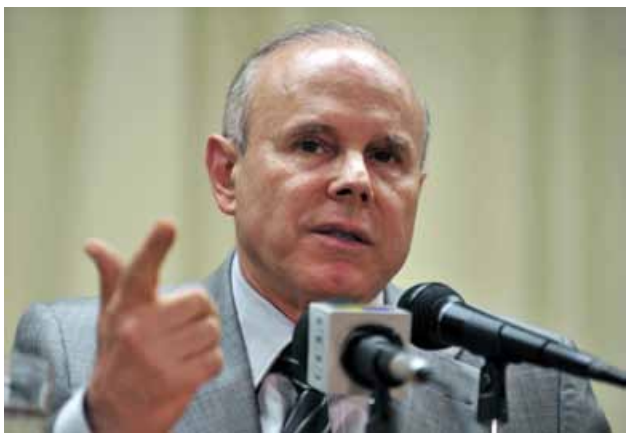


Photo: Renato Araujo/Agencia Brasil

Finance Minister Guido Mantega

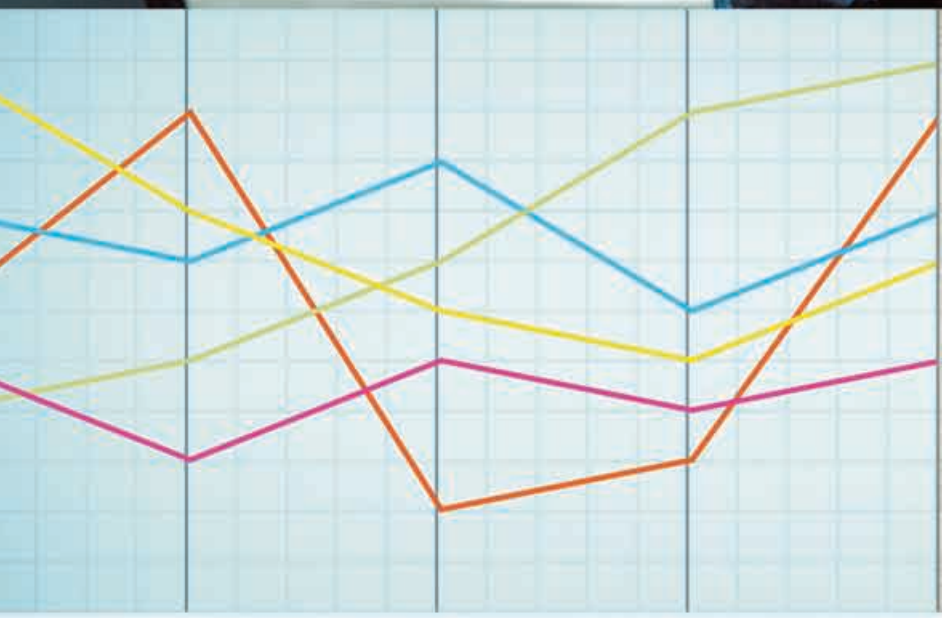
Finance Minister Mantega announced that to limit capital inflows, stem appreciation of the real, and restrict credit growth, the 6% tax on foreign loans would be extended to cover maturities of up to 2 years (from 1 year). He warned that more aggressive measures are possible. (April 7)

INDUSTRIAL POLICY

President proposes a Department of Micro and Small Enterprises

As she promised before election, President Rousseff has sent Congress a proposal to establish a Department of Micro and Small Enterprises, which account for half the jobs in Brazil. Its head would have ministerial status and report directly to the President. (March 31)





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What's not working in the tax system

If anyone should know how to get round the bottlenecks in the tax system, it's a former Secretary of the Federal Internal Revenue Service. Yet Everardo Maciel, now a tax consultant, says it took him a whole day, not to mention US$200, simply to get digital certification authorization for transmitting tax statements over the Internet. You can imagine what a challenge dealing with the tax system is for anyone without Maciel's expertise — even if you haven't already tried to do it yourself. And we all have, at least all who want to pay our share even though the government assumes we're guilty until proven innocent.

The burden of taxes and social contributions in cash terms adds up to 35% of gross domestic product. The tax burden is high in relation to other developing nations, as Maciel points out, because Brazil has made a political choice to have a generous social security system and universal public health — certainly a choice many of us agree with. And if 35% were all the tax laws cost, it might not be so bad. But the cost of tax compliance adds a significant additional burden, as well as taking huge amounts of time that could be put to more productive uses. For instance, because there's no coordination between federal, state, and municipal tax authorities, it's possible to have a number of different tax identities. And there's also the sheer number of taxes Brazilians have to deal with: as tax accountant Mauricio Tadeu de Luc Gonçalves laments, there are 66 different types of taxes, over a million laws — and every three minutes one of them is updated.

The burden of taxes and social contributions in cash terms adds up to 35% of gross domestic product. But the cost of tax compliance adds a significant additional burden, as well as taking huge amounts of time that could be put to more productive uses.

For years proposals have been put forward to harmonize the 27 different state laws for the VAT on Goods and Services, the main state tax. Nothing has happened — because that tax accounts for 83% of state revenues. No matter that if states made the VAT easier to handle, more entrepreneurs might be willing to open up businesses and some of it would be replaced. Bahia state offers a model: it simply resolved a conflict between two public career paths by redefining the responsibilities of one group, tax analysts, and VAT collections shot up 36%.

Ironically, Brazil has one of the most technologically advanced tax administration systems in the world. But as Maciel's experience shows, you have to fight through many layers of bureaucracy to access it. And the pitfalls are numerous . . . so numerous that many companies have to hire special tax experts to monitor the work of their accountants because incorrect information generates fines. That's another cost beyond the actual tax rates that undermines the competitiveness of Brazilian companies.

The situation is worsened by the copious number of tax instruments available, such as tax substitution and tax withholding. Even options like the National Simple system for small companies, which combines reporting for six federal taxes, plus state VAT, plus the municipal services tax, belies its name. Not only has the government introduced a number of restrictions, it also failed to index earnings limits, so small companies fall out of the category before they really get on their feet.

Can anything be done? Maciel says it can: "Most of our tax blockages do not need constitutional amendments. His solution: "Just drop what is not working and keep what is."

Where is the opposition?

After their third consecutive defeat in presidential elections and with serious internal crises, the two main opposition parties are struggling to survive as well as find an appealing message to voters. There is, however, growing dissatisfaction with the two major political forces in the country. Whoever translates this dissatisfaction into a clear message will tap into a vast pool of political capital.

João Augusto de Castro Neves, Washington D.C.

After a third consecutive defeat in presidential elections, the relevant question now is this: is there any light at the end of the tunnel for the political opposition in Brazil? As if a backdrop of sustainable economic growth — the highest in recent years — and high levels of presidential popularity were not enough to make life difficult for them, the fact that the two administrations (Lula and Rousseff) led by the Workers' Party (PT) adopted and built on policies launched by the Cardoso government led by the Party of Brazilian Social Democracy (PSDB) seems to make criticizing the PT administration nearly impossible, let alone finding an alternative message to offer voters.

Opposition in disarray

The problem lies mostly within the PSDB itself. Dumbfounded by the political savvy of President Lula (PT), the PSDB, Brazil's biggest opposition force, has spent what is left of its political capital on dubious, if not counterproductive, goals. First, it insisted on a selective approach in its only experience in power (1995–2003). While claiming responsibility for stabilizing the economy (the Real Plan) and launching conditional cash transfer programs to the poor that were later bundled up by Lula as the Family Grant program (Bolsa Familia), PSDB leaders fumbled for words when more controversial issues arose, such as privatization of state-owned enterprises. This reluctance alone claimed two presidential losers, Serra in 2002 and Alckmin in 2006.

It also seems that in the last several years the PSDB has paid little or no attention to the fragmentation of political parties and the surge of presidential popularity. Instead of crafting a clear message and building a strong political coalition, PSDB leaders have preferred to concentrate their time and efforts on internal disputes. Since electoral laws restrict campaign activities to specific periods and there is a lack of grassroots activism in the party, it is hard to avoid recognizing this situation for what it really is: personal disputes among party leaders. And while the leaders struggle with dissent, the party dwindles in both houses of Congress.

Meanwhile, with the defection of the Mayor of São Paulo City Gilberto Kassab and the Deputy Governor of São Paulo state, the second main opposition party, the right-of-center Democrats (DEM), has almost disintegrated. Kassab and Afif Domingos intend to set up a new party, the Social Democratic Party (PSD).

Lacking the numbers and the strength to block the legislative steamroller that is the governing coalition, the opposition's main hope today lies in a possible deterioration of the economy, because it is widely believed that the Lula administration survived a string of corruption scandals and was able to guarantee a "third term" with Rousseff mainly because of a favorable economic situation.

But would an economic slump be enough to revive the opposition? To cheer for the worst may not be a patriotic strategy for someone who seeks the presidential chair, but desperation seems to thrive where there is a lack of ideas. In the 2002 election the PT moved to the center, pushing the PSDB into a more conservative (and uncomfortable) stance. Today, the tucanos, as PSDB members are known, confront a conundrum: how and where to reposition their message to Brazilian voters. While joining forces both in Congress and in presidential races with their more conservative counterpart, the DEM, the PSDB's main leaders, former governor and presidential candidate José Serra and senator Aécio Neves, flirt with a more leftist agenda to try to compete with the PT on its own turf. But together Serra's credentials as a somewhat state-oriented developmental economist and Aecio's tentative courtship of labor unions send mixed signals to voters.

None of the PT's three consecutive presidential victories was a landslide, and the ballots in 2010 prefigured a trend that may gain importance in elections to come, namely the emergence of a third political force that may break down the 15-year PSDB-PT bipolarity.

Voter dissatisfaction

Nevertheless, to recognize that the PSDB-DEM opposition bloc is mired in an excess of egos and a lack of ideas is not the same as saying that there is no viable alternative to the PT-led





Photos: Valter Campanato/Agencia Brasil.

Senator Aécio Neves (PSDB) (left) and former São Paulo governor José Serra (PSDB) flirt with a leftish agenda sending mixed signals to voters.

government. None of the PT's three consecutive presidential victories was a landslide, and the ballots in 2010 prefigured a trend that may gain importance in elections to come, namely the emergence of a third political force that may break down the 15-year PSDB-PT bipolarity. The nearly 20% of the voters who went to Marina Silva of the Green Party (PV) may not necessarily be environmentally conscious; rather, they suggest a growing dissatisfaction with the two major political forces. Whoever is able to translate this dissatisfaction into a clear message will tap into a deep pool of political capital.

Meanwhile, what are the prospects for the opposition up to the next presidential election in 2014? First, a frail opposition in Congress is not likely to function efficiently enough as a shadow cabinet to create major problems for the government (though the administration will have its hands full dealing with its own governing coalition). Second, the divisions between PSDB leaders will probably harm the party even more if they are not dealt with sooner than in previous electoral cycles. Third, there is room for some surprises in the political landscape, either with consolidation of another political force behind Marina Silva or even with a new party or political group that may occupy the vacuum in Brazil's conservative camp today. But on a more objective note: the main event in 2014 will certainly be not the election but the World Cup.

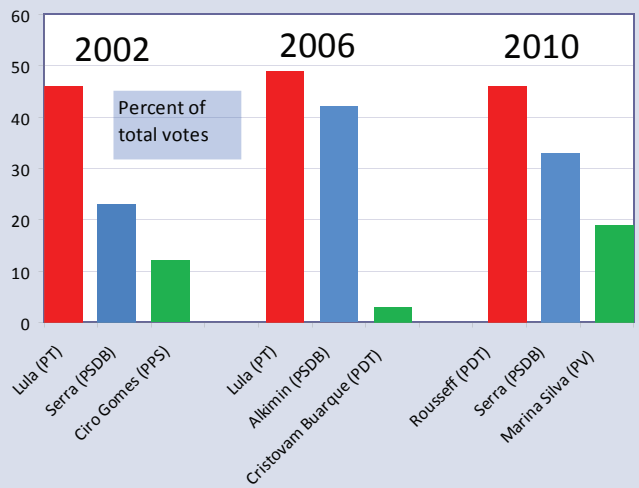




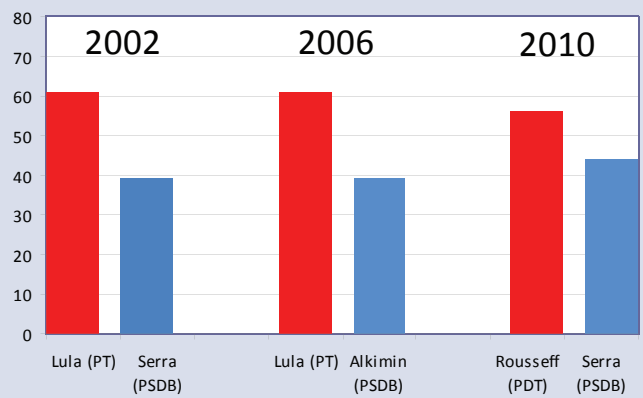
Photos: Fabio Bozzebom and Antonio Cruz/Agencia Brazil.

Democrats (DEM) have almost disintegrated with the departure of Mayor Gilberto Kassab (left) and Deputy Governor Afif Domingos.

Despite all odds, the opposition totalled 52 percent of the votes in the first round of the last presidential elections ...



... and 44% of the votes in the runoff, 44 million votes.



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The benefits and costs of presidential beliefs

In the national debate, the ideological and programmatic inconsistencies of politicians and parties are often criticized. In this Babel of vagueness and contradictory positions, it is encouraging that President Rousseff has tried to present clearly her ideas on how to govern Brazil.

In a recent interview with the *Valor Econômico* newspaper, Rousseff's arguments were precise, and she showed an openness to discuss differences — attributes rarely found among politicians. This would be something to celebrate if not for one crucial question: Are the president's ideas and arguments correct?

We have argued before in this column that prospects for the Rousseff administration are quite favorable. Holding to the rule of raising the minimum wage, the income of the poorest Brazilians would continue to grow. Moreover, though this policy might imply higher social security and welfare spending, a possible (and feasible) increase in taxes could finance it. The gains in revenue would also make viable budget surpluses and execution of public investments to upgrade Brazil's infrastructure for the World Cup in 2014 and the Olympics in 2016. Combining higher income for the poor and economic growth of about 4% a year, Rousseff would be in a very strong position for reelection in 2014.

In light of the president's frank interview with *Valor Econômico*, it is necessary to reassess this scenario. An undoubtedly positive note in the interview was the government's intention to speed up concessions for such public utility services as airports and roads. If this materializes, there will be some extra fiscal relief, since the Treasury will not alone have to pay for the entire infrastructure necessary for the coming sporting events.

The interview becomes more worrying, however, when Rousseff addresses the issue of inflation. Here, the president does not seem to connect cause and effect. She says, "I will not negotiate with the inflation rate. I will not. And I do not think that inflation is demand-driven in Brazil." In an economy where consumption and investment grow above what is produced for many consecutive quarters, where unemployment is at its historic lowest, and where inflation in services runs about 8% a year, it is difficult to argue that demand is not excessive.

What the president had to say is even more disturbing when it reveals adherence to a certain view, quite old in these latitudes, on how inflation works — for example, that investment does not cause inflation because it contributes to raising

> The president seems to believe that we can fight inflation without reducing the rate of growth. This is a belief that has long been held by Brazilian elites.

future supply, helping to curb rising prices. In other words, the president seems to believe that we can fight inflation without reducing the rate of growth. This is a belief that has long been held by Brazilian elites. It was the dominant thinking in the 1950s, during the Juscelino Kubitschek administration, which ended with inflation soaring. This was also the belief during the oil shock of 1973, again with dire consequences. Curbing inflationary pressures only by increasing supply without containing domestic demand leads to a surge in inflation and eventual disruption of production.

The risk of inflation is exacerbated by recent exchange rate management policy. Previously, whenever there was an increase in prices of commodities — of which Brazil is a big exporter — the resulting exchange rate appreciation would offset part of the inflationary effect of the rising commodities prices. Thus commodities and foreign exchange functioned as a perfectly balanced seesaw, insulating the country from an external supply shock and preventing transmission to other domestic prices.

The problem, however, is that if the gain in terms of trade in recent months were to go unchecked, the Brazilian *real* would rise to a level that would be devastating to domestic industry. To keep the exchange rate from appreciating, the central bank buys foreign currency, accumulating reserves that, with high domestic interest rates, are an enormous financial cost for the Treasury. Hence, there has emerged a new government goal: holding the exchange rate to levels compatible with a competitive domestic industry. This demands considerable Treasury resources and neutralizes a useful means to contain inflation, exchange rate appreciation.

Curbing inflationary pressures only by increasing supply without containing domestic demand leads to a surge in inflation and eventual disruption of production.

The new economic policy framework seems to have the conscious and thoughtful support of the president. Because she has firm convictions on all these policy issues, she is unlikely to have the pragmatic flexibility of her predecessor. An emblematic example of Lula's presidency was the unceremonious dumping of the long tradition of Workers Party social thought reflected in the failed Zero Hunger program in favor of the rationality of the Family Grant program, which has become one of his most celebrated achievements. Lula also sailed undaunted through phases of economic policy that were sometimes more, sometimes less orthodox, according to the thinking of his Finance Ministers — the more liberal Antonio Palocci and the more interventionist Guido Mantega.

With Rousseff, it is conceivable that economic policy will stay on the course determined by her beliefs. Still, her reasonableness suggests that she will review policies if initial choices turn out to be wrong. If they do, there will then be the big question of what will be the price for the president's education.

Brazil's dysfunctional tax system

Liliana Lavoratti, Rio de Janeiro

There is a great paradox in the Brazilian tax system: although its tax administration is among the most modern in the world, it is nevertheless gargantuan, complex, and imposes high costs on families and businesses in meeting their tax obligations. Resolution of the paradox, however, lies more in improving management of the system than in changing laws. Rather than tax reform, it is essential to have good management.

That is how Everardo Maciel, tax consultant and former Secretary of the Federal Internal Revenue Service (IRS), summarizes his views on Brazil's tax system. "The tax burden is clearly high in relation to other developing nations, but this is due largely to the political choice of having a generous social security system and universal public health," he says. That is why the tax burden and social contributions are about 35% of gross domestic product (GDP).

A quite different question is the cost of compliance — what it costs taxpayers in terms of both finances and time to stay current with their tax obligations. Compliance is very expensive even though, driven by public policies implemented since 1995, Brazil is a world champion in using new information and communication technologies in tax matters. The country pioneered sending income tax information over the Internet, prompting Bill Gates in 1997 to say that tax administration in Brazil was an example for the U.S., Canada, and Australia.

"It's as if we had a Ferrari that despite high speed always comes in last," Maciel says. Consequently, there is extensive planning and a proliferation of disputes related to tax. "It is common for tax consulting offices to offer taxpayers package solutions, ranging from the opening of legal discussions to using legislative loopholes to reduce the amount of taxes paid."

The roots of this situation lie in the taxation model Brazil has adopted. Maciel is convinced that "No other country lays out in their constitution a taxation model as analytical and broad as Brazil. [And] one of the dangers of most tax reform proposals is that they would deepen these distortions

and increase the number of tax rules in the Constitution."

Growing complexity

Another factor is that, although taxpayers have access to modern tools, the federal, state, and country mechanisms overlap. Maciel explains that a single tax entity like a company has different identities for the federal government, the state, and the county. And if the company operates in more than one state, such as Rio de Janeiro and São Paulo, it would have additional identities.

The copious number of tax instruments is another flaw in the tax system, according to Maciel. Certain instruments, such as tax substitution and tax withholding, have been misused. "What was to happen in exceptional situations became the general rule," he says. Also missing is creativity to overcome barriers in relations between the IRS and the taxpayer. For instance, with regard to digital certification authorization for transmitting tax statements over the Internet, Maciel says, "I had to allot a day to do this, introducing myself with a copy of my company's social contract, in addition to paying US$200."

Mauricio Tadeu de Luca Gonçalves, a tax accountant who is director of Partwork Associados, adds that a company has about 30 ancillary obligations before the Bureau of Internal Revenues and state and municipal tax bureaus. Besides the annual declaration of income tax, there is the state Information and Analysis Guide (GIA), and the county Electronic Declaration of Services (DES). "This is required for taxpayers to monitor their own activity," he says.

In Brazil the assumption seems to be that the citizen is dishonest until proven otherwise, as Minister Hélio Beltrão has stated in the past. From this premise was created a tangle of laws to tie the citizen. "Even those who seek to act properly are penalized by the minority who want to escape the rule," says Amir Khair, a specialist in public finance and consultant.

> *"No other country lays out in its constitution a taxation model as analytical and broad as Brazil. [And] one of the dangers of most tax reform proposals is that they would deepen these distortions and increase the number of tax rules in the Constitution."*
>
> *Everardo Maciel*

Unlike the United States, which assumes that people are honest but punishes offenders harshly, in Brazil every time the National Congress, legislative state assemblies, and county councils come up with new laws, they all regulate these measures, issue decrees, and thus elaborate the legislation. "Not even Jesus Christ can keep up with so many details," Khair says, adding that ultimately the result is to overload the courts.

For a company that hires someone to take care of all this, Luca Gonçalves says, the cost "may represent twice as much as the wages paid." Although it was a step forward, the National Simple system (a combination of six federal taxes, plus the state taxes on goods and services, and the municipal services tax) failed to provide benefits after the initial changes. In recent years, says Luca Gonçalves, "The rates have ended up being higher, and the rules are not so clear."

Consultant Carlos Eduardo Rocha

Campos, owner of Polimax Brasil, agrees. When he opened the company a few years ago, it enjoyed the benefits of the Simple category, but, he says, "The restrictions introduced by the government and a failure to raise the earnings limits excluded our company. Basically, this was a disguised way to raise taxes."

Such decisions constrain growth. "It's not easy to do business in Brazil. Many investors think twice before expanding their businesses because of the headaches and lack of incentives," Campos believes.

Gargantuan tax system

Another aspect of the tax issue is excessive bureaucracy. Luca Gonçalves points out that, when a business is being opened, it must register with the Board of Trade, the Notary, the IRS, the state government, the county, Health Surveillance, and a variety of other government departments, depending on the activity. Corporations must publish their balance sheets. Then there are tax obligations. Today in Brazil there are 66 types of taxes, a maze of over a million laws, and every three minutes one of them is updated. "It's a patchwork; tax laws are not replaced, but only one or two paragraphs of a particular law are changed," Luca Gonçalves says.

This situation can overwhelm even a competent tax and accounting department. "Besides having someone do everything right, it is essential to have someone else reviewing it. If you stay only in the hands of an accountant or tax expert, details may be missed due to the vast volume of information and statements that companies have to deliver," says Marcelo Lico, a partner at Macro Auditoria e Consultoria, an auditor and consulting firm serving small and medium enterprises.

Today, in Brazil there are 66 types of taxes, a maze of over a million laws, and every three minutes one of them is updated.

"[The tax system] is a patchwork; tax laws are not replaced, but only one or two paragraphs of a particular law are changed."

Mauricio Tadeu de Luca Gonçalves

"From a technological standpoint we are super advanced, yet most tax professionals are still not prepared to generate the information correctly."

Marcelo Lico

"The pursuit of an efficient tax system also involves the devolution of power in the civil service."

Silvia Helena de Alencar Felismino

With knowledge gained in 22 years in this area, Lico has no doubt that Brazilian tax technology is among the world's best. "Nowadays, almost everything is electronic. The Public System of Digital Bookkeeping should be fully implemented next year and will tie together all the federal, state, municipal, and social security data, allowing more effective cross checking. It all started when electronic invoicing became increasingly widespread here," he says.

This gargantuan tax system, Lico says, may complicate the daily lives of taxpayers, but as

an electronic supervision system it makes life easier for public tax administrators, who are short of staff. The previous manual process was susceptible to errors and fraud. "From a technological standpoint we are super advanced, yet most tax professionals are still not prepared to generate the information correctly," he warns. For example, there are 27 different state laws for the VAT on Goods and Services (ICMS).

Following all these tax issues is no longer a job for accountants alone. "The trend is for companies to have a high-level tax expert to monitor it all," Lico says. "Incorrect information can generate a fine and require the company to argue its case in administrative and judicial proceedings." He also sees the demands increasing for individuals, who can now fall into the IRS net when information in various fiscal databases is cross-checked.

Silvia Helena de Alencar Felismino, president of the National Sindireceita, the union of IRS tax analysts, points out another taxpayer difficulty: "Importers and exporters can become victims of the poor definition of responsibilities between inspectors and tax analysts, the two top-level careers in the IRS." Turf struggles between two civil servant career paths can disrupt clearance of goods at customs. "Tax analysts cannot complete customs clearance, as they used to do. Yet the final part of this process depends on a tax auditor to sign documents," Felismino says. A possible model solution, she points out, comes from the Treasury of Bahia state, which expanded the powers of its tax analysts, resulting in an average increase of 36% in VAT collections. "An efficient tax system involves the devolution of power in the civil service," she concludes.

Is tax reform possible?

If there is consensus on the need for simplification, why does it not happen? Although it has been one of the main tax reform proposals put forward for discussion in recent years, the 27 different state laws for VAT on Goods and Services (ICMS), the main state tax, have still not been unified. Expert on public accounts Amir Khair points out that "As much as the federal government works for unification, changing the ICMS is changing what is the source of 83% of state government revenues. Any change represents a threat of lost resources, and the natural reaction of state delegations in Congress is to stand firm against any attempt to change."

The result is a "Frankenstein" tax system. Khair explains, "This has nothing to do with this or that government or with political parties. It is an issue related to the federation agreement, and the division of responsibilities and tax revenues between the federal government, states, and municipalities." He advocates adoption of new alternatives like the National Simple system that makes taxes cheaper for micro and small enterprises; it is "a pragmatic measure of simplification," that does not require constitutional amendments. "It's a misperception to think that simplifying the tax system will reduce the tax burden. It is more likely that the rates will rise and the tax burden will increase," Khair concludes.

Everardo Maciel, tax consultant and former IRS Secretary, also believes that, "it's a waste of time to carry on this debate. Most of our tax blockages do not need constitutional amendments. And rebuilding the tax system from scratch would create unnecessary chaos." He does not deny the existence of problems, but believes that to solve them, "just drop what is not working and keep what is."

Silvia Helena de Alencar Felismino, National Sindireceita president, also advocates simplification and has some good words to say for the repealed Provisional Contribution on Financial Transactions (CPMF): "This type of tax is perfect to check tax evasion. Not that I want the CPMF back as it was, but it could be restored with only a symbolic rate to facilitate supervision."



BUILDING FOR A MORE COMPETITIVE BRAZIL

Removing the infrastructure straightjacket is critical for Brazilian economic growth and hosting of the World Cup in 2014.

Solange Monteiro, Kalinka Iaquinto and Thais Thimoteo, Rio de Janeiro

In 1970, when Mauro Viegas began working at his father's company — Concremat, which offers engineering, inspection, and geotechnical services in Rio de Janeiro — it had 100 employees. Today, as CEO Viegas has almost 6,000 employees and close to R$1 billion in contracts. "We have never had the growth we see now," he says. In recent years, the company has increased sales by 20% annually.

Concremat is a good example of what the Brazilian heavy construction industry is experiencing today. Driven by the federal Growth Acceleration Plan (PAC), greater demands for energy, and construction for the World Cup and the Olympics, companies have restructured themselves in a race to secure the best contracts, scarce trained labor, and capital. "Undoubtedly, the industry will grow very significantly in coming years," says Jose Carlos Martins, director of the Brazilian Chamber of the Construction Industry (CBIC). "And two concepts will guide this growth: technological innovation and environmental sustainability."

While investments in deep sea oil projects are the most obvious, relieving deficiencies in Brazil's infrastructure is gaining prominence. Transportation bottlenecks threaten to become a straitjacket for Brazilian economic growth. For example, Andrade Gutierrez Group's portfolio of transportation works, including roads and urban subways, accounted for 19% of the total portfolio in Brazil and Latin America in December 2010. "We anticipate a growth of 72% for December 2011," says Rogério Nora de Sá, CEO of the company.

It is estimated that by 2011 to 2014 Brazil will attract US$128 billion in investments in ports, railways, and highways alone.

"The infrastructure is considered a priority," says Dalmo Marchetti, Manager of the Logistics Department of the National Bank for Economic and Social Development (BNDES). "Our estimate is that by 2014 Brazil will attract US$128 billion in investments in ports, railways, and highways, of which BNDES will contribute R$44 billion."

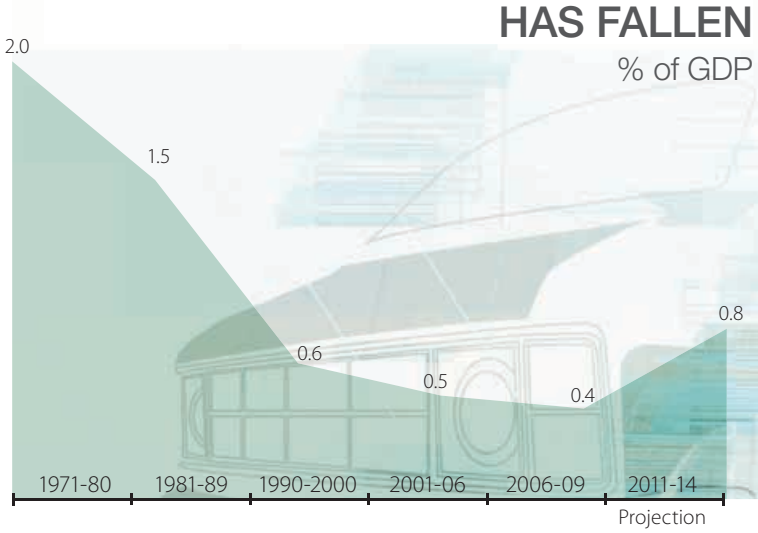
Bottlenecks

Paulo Resende, professor at the Dom Cabral Foundation (FDC), is carrying out a study of the competitiveness of Brazil's construction industry for the World Economic Forum. He explains that compared with the U.S., "In the case of transport over long distances, we lose by 50%. That is, for every dollar spent in the U.S. to ship cargo, we spend US$1.50."

A 2009 survey by the National Confederation of Transport (CNT) found that despite recent improvements, the condition of the roads raised logistics costs by 20% to 40%. "This is a big problem, since 60% of freight in Brazil travels by roads compared to only 26% in the United States," says Carlos Campos Neto, coordinator of Economic Infrastructure of the Institute for Applied Economic Research (IPEA). Yet as scarce resources for infrastructure are channeled to the roads, the media report long queues of ships waiting offshore to dock and airline passengers suffering long delays.

"Long waits for passengers at airports is the visible part of the problem, but nobody talks of problems with air cargo," laments Manoel Matos, president of the Brazilian Chamber of Electronic Commerce (Câmara e-Net). Orders for his members generally have time constraints and are low volume and high tech, making air transport ideal. This type of business has grown in Brazil at rates of 40% a year; the main operator is the Post Office. "In 2010 alone, e-commerce won 6 million new customers; the total of 23 million customers made 40 million transactions of physical goods alone," Matos says. "But we cannot expand mobile telephony and Internet access if we cannot deliver more widely at competitive prices. This mainly impacts small and micro businesses."

INVESTMENT IN TRANSPORTATION HAS FALLEN



Source: National Bank for Economic and Social Development (BNDES).

It is not easy even for big businesses, as Ricardo Cunha knows well. He is director of logistics for the Mexican appliance company Mabe, which has operations in 15 countries. Brazil is Mabe's largest market, accounting for 30% of its sales, though at a high cost. Its five factories in Brazil are all in the interior of São Paulo state. "We have made such moves as relocating distribution centers to optimize the use of various freight transportation modes," Cunha says. "Bottlenecks in ports, railways, and roads and tax differences between states make Brazil the highest cost and most complex of all the countries where Mabe has commercial relations," Cunha says. "We are not very optimistic; what is being discussed now has been discussed for a long time with no concrete decisions made. Even if something is done, it will take time to bring benefits."

Private sector dynamism

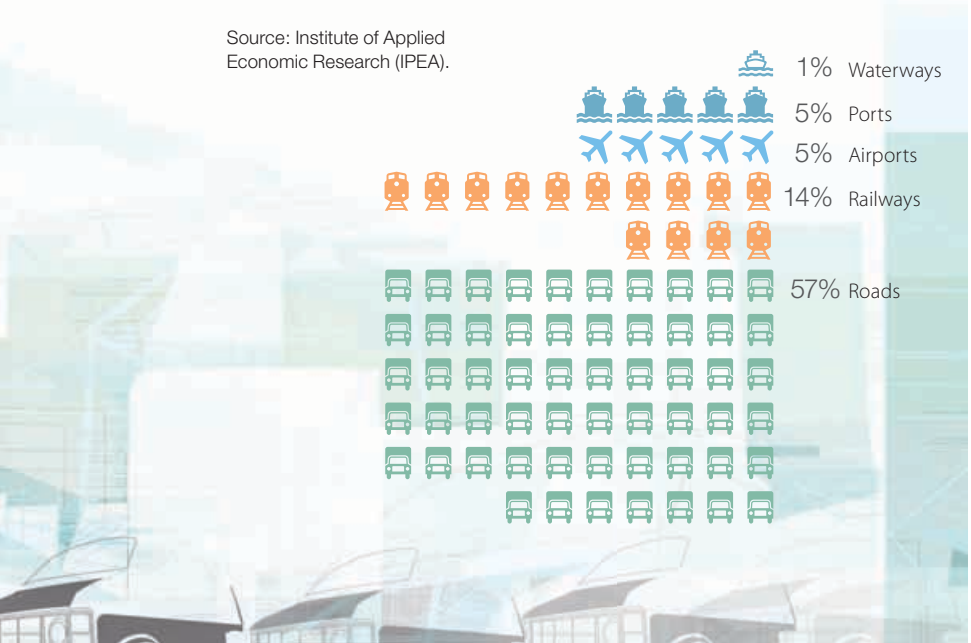
Both infrastructure users and companies that build infrastructure are asking that regulations be simplified and that government be more open to private participation in the sector. "The government has no resources, is an abysmal manager, and makes things more difficult — take environmental permits, for instance" says Martins. "Brazil is now a darling for investors, so it is necessary to eliminate political interference and infighting among jurisdictions and allow regulators more autonomy to eliminate legal uncertainties and attract the private sector." Nora de Sá from Andrade Gutierrez also defends the legal protection of contracts, "in addition to financial security and balance of contracts with the government, " he says.

For the construction industry, such changes mean not only speedier bid decisions and execution of lucrative contracts but also allowing for more private participation in operating infrastructure systems.

A 2009 survey by the National Confederation of Transport found that despite recent improvements, the condition of the roads raised logistics costs by 20% to 40%.

INVESTMENT SHARES BY TYPE OF TRANSPORTATION

Source: Institute of Applied Economic Research (IPEA).



COSTS BY TRANSPORTATION TYPE

	US$ cents/ton Km
Air transportation	14
Roads	4 to 5
Railway	0.3 to 1
Cargo ship	0.06 to 0.24
Bulk cargo ship	0.02 to 0.04

Source: Graduate Business School of the Federal University of Rio de Janeiro (Coppead-UFRJ).

Besides participating in road concessions in Brazil, for instance, construction giant Camargo Correa is also involved in concessions for railway cargo transport in Argentina and administration of airports elsewhere in Latin America and the Caribbean. "These companies are developing internationally, even though it will take at least another 10 years to address pent-up demand for great infrastructure works," says Paulo Vincente, professor of strategy at the FDC. For Andrade Gutierrez Group, concessions accounted for about 15% of gross revenues in 2010. "The importance of the revenue generated by concession contracts is due to their long-term stability and synergy with the group's business interests," says Nora de Sá.

Another example is the Odebrecht Company, which in March 2010 created a new company, Odebrecht TransPort (OTP), which deals only with logistics. By year-end OTP had equity of R$1.4 billion. It expects to invest R$6 billion by 2015. Private investment in infrastructure is necessary to remove major bottlenecks and improve public services. Among OTP's ambitious projects are Embraport at Santos Port — the largest private multipurpose port terminal in the country, on which construction began in 2010 — and (in association with Camargo Correa, Coopersucar, and Cosan) a vast logistics system, Logum, covering four states, for storage and transportation of ethanol. Logum also demonstrates the power ethanol producers have gained in finding logistics solutions to ensure their competitiveness.



Both users and companies responsible for infrastructure construction are asking that regulations be reviewed and simplified and that government be more open to private sector participation.



AIRPORTS TAKING OFF?

Earlier this year President Rousseff made news by announcing that private participation in the expansion of airports is necessary and that the government would clear the way for that by the end of June. FDC's Resende comments that "If that intention is realized, it can be very positive: it creates a competition that in general the more efficient private sector ends up winning."

The greatest fear among experts is that, given the slow pace so far, Brazil will not be prepared to host the World Cup in 2014. Of the estimated R$5.6 billion in investments needed for airports in the 12 cities hosting the World Cup, between 2007 and 2010 only R$163 million in projects were fully carried out, according to a PAC assessment. In the first two months of 2011, only R$53.8 million were spent, which is just 2% of the total amount of R$2.2 planned for this year.

According to the Brazilian Airport Infrastructure Company (Infraero), "Between 2011 and 2014, the company expects investments of R$9 billion in 67 airports, of which R$5.2 billion is earmarked for cities hosting the World Cup." Peter Wanke of the Graduate Business School of the Federal University of Rio de Janeiro (Coppead-UFRJ) is skeptical about these estimates: "It is difficult to judge without knowing details of the plans. In any event, we risk just doing more of the same, instead of thinking of logistics in an integrated way, including access to airports."

Of the estimated R$5.6 billion in investments needed for airports in the 12 cities hosting the World Cup, between 2007 and 2010 only R$163 million were fully carried out.

ABOVE AVERAGE

Air transportation growth

(Billions of passengers transported per Km)

	1978	part. %	1988	part. %	1996	part. %	2008	part. %	cresc. % 2008-1978
Brazil	11	1	24	1	38,3	1,6	68,9	1,6	526,4
Latin America and Caribbean	41	5	79	5	89	4	190	4	362
North America	338	41	721	42	1,012	42	1,386	36	310
World	818	100	1,699	100	2,417	100	4,283	100	424

Source: International Civil Aviation Organization (ICAO, 2009).

The fact is that regardless of the World Cup, the economy's growth, and the increase in per capita income, it has become clear that advances in civil aviation — better services and lower costs through technological modernization of airplanes and business models — have not carried over to airports, as the numbers prove. According to Infraero, between 2005 and 2010 the number of passengers — domestic and international — grew 61%. A study of the Research Center ofCoppe-UFRJ, coordinated by Professor Elton Fernandes, found that even after government's planned improvements there will still be a shortage of 366,000 square meters at airports to accommodate the expected volume of passengers in 2014 — and this does not take into account the additional demand caused by the world sporting events, which could reach 3 million. "The average in major international airports is 29 square meters per passenger in peak hours. Here we have less than 23 square meters, except for Tom Jobim Airport in Rio de Janeiro and Manaus," Fernandes says.

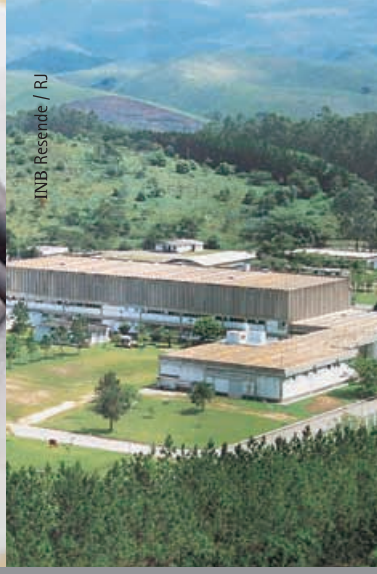
The first airport concession in the country, to be built in São Gonçalo do Amarante, Rio Grande do Norte, is expected to be the largest cargo terminal in Latin America and the seventh largest in the world, with an area of 15 million square meters. The project edict, which could be a model for other Brazilian airports, took five months to be analyzed by the Court of Audits, being finally approved on April 13. Meanwhile, building companies like Queiroz Galvão, Andrade Gutierrez, and Odebrecht have been dreaming of getting it. The project is expected to be finished by 2014, and the winner would win a management contract for 28 years.

"If we look at Southeast Asia, we see that those countries have improved their airport infrastructure thanks to increased air cargo exports," Campos explains. "Over the next 30 years, it is estimated that air traffic in Brazil will triple, while the world will double. We must prepare properly for that."









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ON THE ROAD

Campos says that part of Brazil's logistics deficiency reflects over-reliance on road transport, particularly for agricultural products. This originated in the 1960s and 1970s, when road-building was financed by a tax on fuels and vehicles. By 1980 federal roads had spread from 8,675 km to 47,487 km. The ban imposed by the 1988 Constitution on earmarking tax revenues put the brakes on road investments. "In the 2000s, despite receiving more than half the funds allocated for transport, investment was insufficient to maintain and expand roads," Campos says. An IPEA survey indicates that today it would take R$184 billion to solve all the problems of roads.

Through concessions since 1995 the government has opened up the possibility of private participation in the operation of state and federal roads. By 2010 concessions had been granted for 14,800 km of roads; the 51 contracts are mainly held by two companies. Studies indicate that, in general, these roads are in better condition than the public ones. "However, we must remember that there is a need to expand the road system where the traffic flow makes private investment unfeasible," Campos says. According to a study by FDC and the World Economic Forum, Brazil has the third longest road system in the world, but only 12% of it is paved.



PRIVATE MANAGEMENT IS BEST

Report card of Brazilian roads

Source: National Confederation of Transportation (2009).

	Public management	Private management
★★★★★ Excellent	30% 22,940 km	81% 11,519 km
★★★★ Good	7% 5,526 km	7% 968 km
★★★ Regular	46% 34,479 km	11% 1,527 km
★★ Poor	12% 8,896 km	1% 201 km
● Very poor	5% 3,496 km	0%

MAJOR HIGHWAY TOLLS

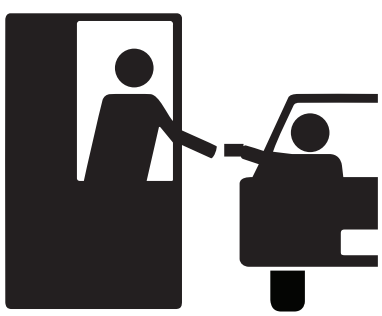
	US$ per 100Km
Nova Dutra • RJ-SP	5.38
Concer • RJ-Juiz de Fora	7.82
CRT • RJ-Teresópolis-Além Paraíba	9.48
Concepa • Osório-PA	5.43
Ecosul • Polo Pelotas	3.61

Sources: Brazilian Association of Highway Concessionaires (ABCR), and National Agency of Land Transportation (ANTT).

Today it would take R$184 billion to solve the problems of roads.

By 2025 the government plans to reduce the weight of roads in the Brazilian transportation system, increasing use of waterways, developing coastal navigation, and increasing transport of cargo by rail. The first 1,574 miles of the North-South rail route, from Maranhão state to Goiás state, could be ready later this year. The expected completion of the railroad has already spurred a number of ethanol projects along the tracks that could bring R$14 billion to the region. However, Wanke warns that the government will have to be realistic about the projects it undertakes. "We have limited money, so we should rethink some projects"; for example, he asks, "Why are we spending R$3 billion for 500 km of high-speed rail when with the same amount we could increase the rail network from 15,000 km to 43,000 km?"

Cristiano Prado, manager of infrastructure and new



Over the next 10 years the government would need to invest about R$43 billion in ports.

projects for the Federation of Industries of Rio de Janeiro State (Firjan), agrees that though it is a worldwide trend to connect large cities by high-speed train, "we need a well-calibrated model so that we do not open a hole in the public coffers." He says that Rio de Janeiro alone is expected by 2013 to attract R$12 billion of investments in transportation and logistics, especially ports: "We need a balanced economic-financial contract, a rate increase, an extension of the concession period, or a decision that the government will build the infrastructure itself." According to Viegas, if the government would make its intentions clear, concession operators would go ahead with their investments, and "in 2011 we could have an additional R$10 billion generated by the private sector, with its own resources."

PRIVATE SECTOR DOMINATES

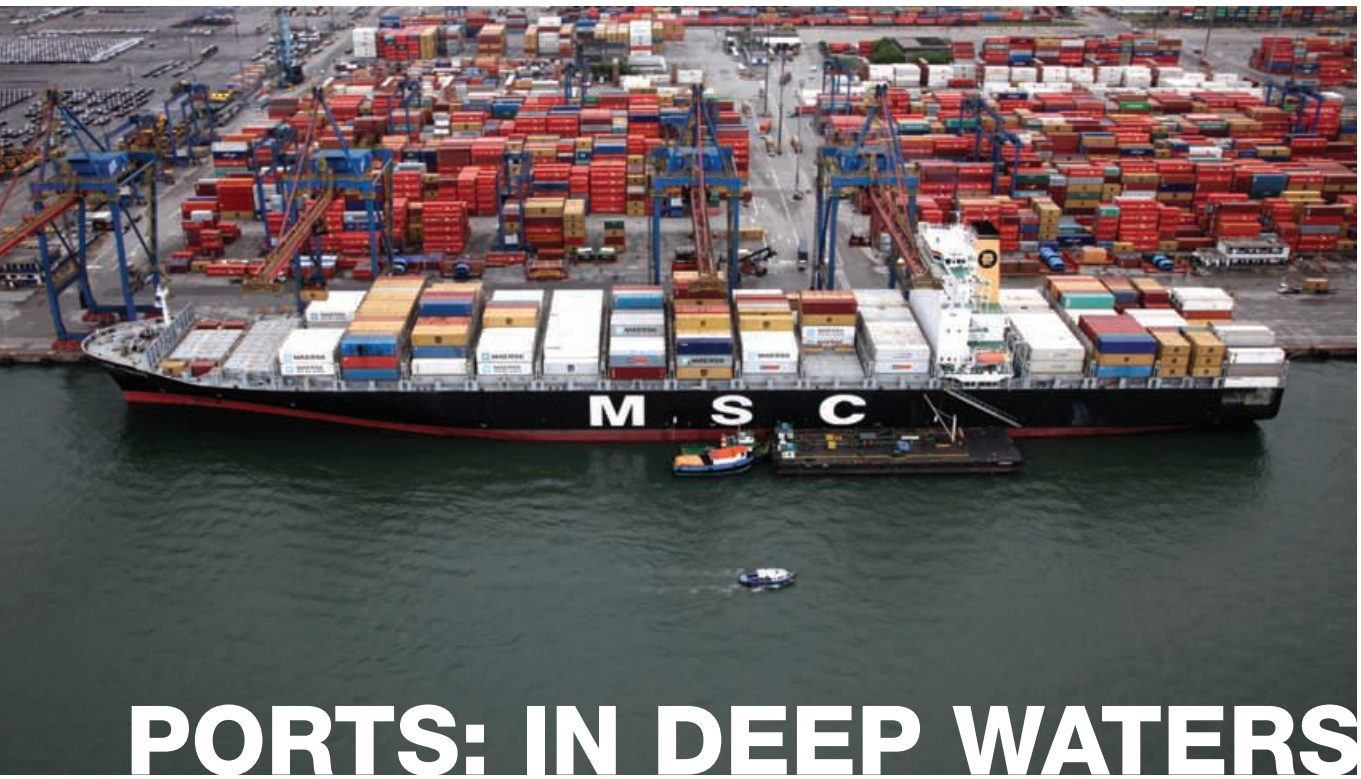
Investments in railways

Millions of Brazilian reais

	2002	2003	2004	2005	2006	2007	2008	2009
Public sector								
Railways	623	197	153	285	390	548	907	994
% in total investment in transport	11	10	4	5	4	5	10	7
Private sector								
Railways	1,620	1,694	2,546	4,045	2,972	3,350	4,933	3,481
% in total investment in transport	41	39	50	65	57	59	63	52

Sources: ABCR, ANTF, Ipea and BNDES.





PORTS: IN DEEP WATERS

Deficient rail and road systems reflect directly on the health of ports, another key infrastructure element. "Owners of port terminals have invested to increase profit, but it is still a challenge to access terminals," says Fernando Camargo, associate director of LCA Consultoria. The dearth of good roads explains in part the high concentration of shipments in a few ports like Santos, which in 2010 represented 25% of Brazilian foreign trade in value and 12% in volume. "Soybeans produced in the Midwest, for example, could be sent to Itaqui Port (Maranhão state), but today there is no infrastructure to do this," says José Roberto Correa, president of the Dock Company of São Paulo (Codesp).

This year, Correa estimates that 101 million tons of soybeans will be shipped, an increase of 10% over 2010. But adapting to increased demand will take a long time. "We have to dredge the harbor and widen the canal, and we will be implementing a new system of traffic information," he says.

Despite the projects planned, many experts consider the port problems to be the most serious. The PAC allocated about R$7.5 billion for ports, but the 2010 IPEA survey estimated that over the next 10 years the government would need to invest about R$43 billion. It also found that 60% of national logistics costs come from freight. Because ships are the cheapest way to transport goods, ports are gaining importance in the intermodal transportation system.[1]

Fernando Graziano is vice president of Constremac Constructions, which specializes in maritime construction. He says that between 1980 and mid-2000s there were few

investments in ports — a big problem for an exporting country like Brazil. Robson Goncalves, consultant for FGV Projetos, adds that Brazil has about 40,000 km of navigable rivers and almost 7,000 km of coastline, yet coastline transport of both goods and people is virtually nonexistent.

If more investment is to be attracted to ports, analysts see a need to revise the industry dynamics. There have been some praiseworthy public efforts, such as the National Harbor Dredging Program, an investment of R$1.5 billion in 17 ports. Another competitiveness-promoting measure would be to introduce a paperless port program to centralize information input for loading and unloading of cargo; this currently involves 28 entities. Correa points out that "in Singapore a container is released in one day; we take five."

Currently, ports may be operated by public or private concession, but private ports need authorization from the government and can provide services only for their own corporations, such as mining, leaving other aspects of the economy in the waiting line to rent

Because ship transportation is the cheapest, ports are gaining importance in the intermodal transportation system.

CONCENTRATED SHIPMENT

Share of main ports in Brazil's trade balance

2010

IMPORTS		
	US$ billion	%
Santos	46	25
Paranaguá	10	6
Vitória	9	5
Itaguaí	7	4
Rio de Janeiro	10	5
Itajaí	7	4
Manaus	6	4
Rio Grande	5	3
São Francisco	4	2
São Sebastião	5	3
outros portos	23	13

EXPORTS		
	US$ billion	%
Santos	50	25
Paranaguá	14	7
Vitória	24	12
Itaguaí	18	9
Rio de Janeiro	7	3
Itajaí	7	4
São Luís	11	6
Rio Grande	11	5
Barcarena	4	2
Salvador	3	2
outros portos	19	9

Source: Dock Company of São Paulo State (Codesp).

space in public ports, which can take up to two years.

"Brazil is competitive in logistics only in oil and mining," Prado says. He cites the example of Angra dos Reis Port Terminal, now administered by France's Technip: "It was practically closed down but now may support the offshore oil rigs." He also cites the new Açu Port of LLX, a logistics company, scheduled for completion in 2012 at an investment of R$4.5 billion. It can accommodate 10 ships with up to an 18-meter draft.

Just as in the 1990s, when the private sector seized the opportunities opened up by the break-up of public monopolies in several sectors of the economy, now the private construction industry awaits its chance to help build a more efficient logistics infrastructure to support the country's growth.

1 Intermodal freight transport involves the transportation of freight in a single container or vehicle that uses several modes of transportation (rail, ship, and truck).

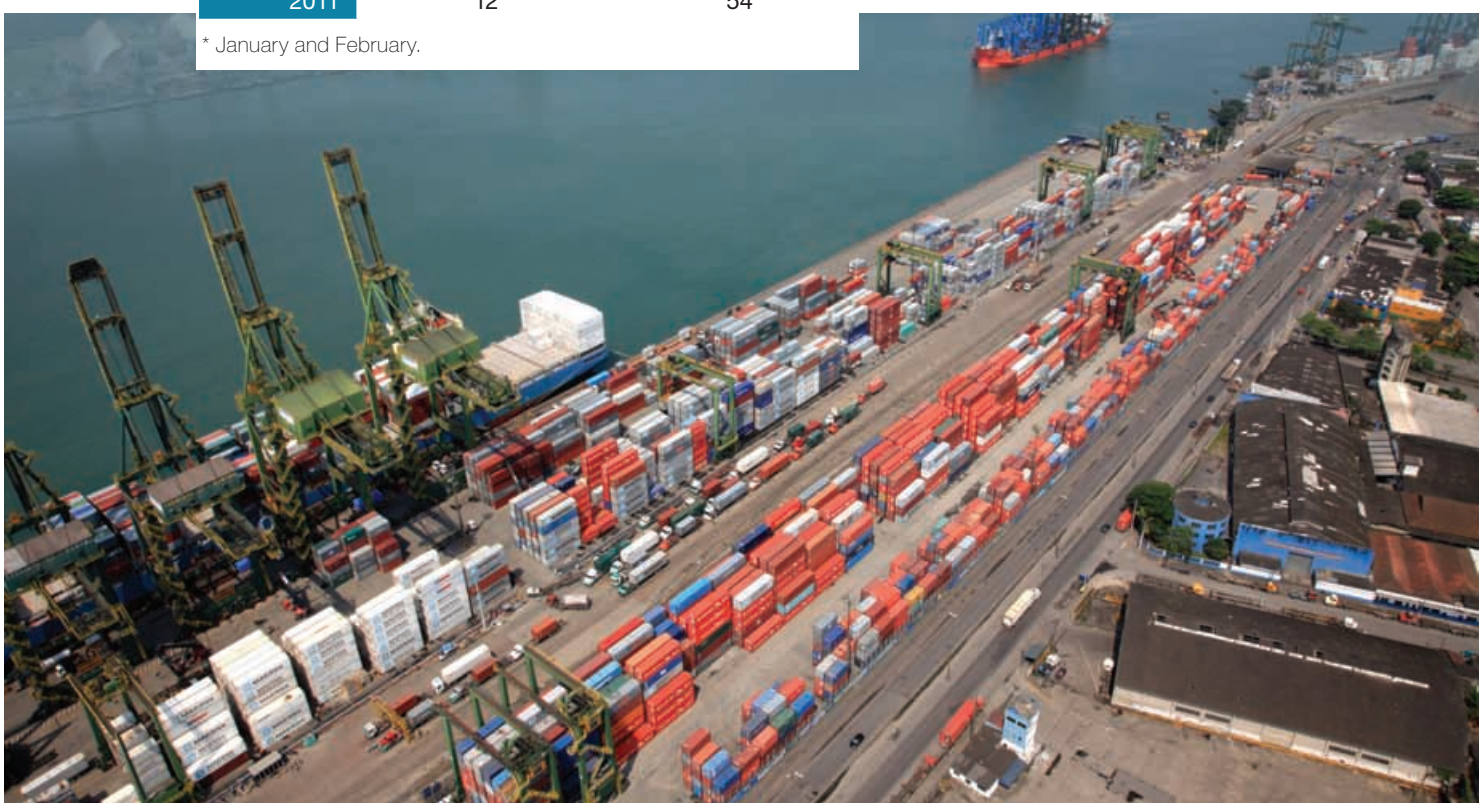
GREAT VOLUMES GREAT CHALLENGES

Shipments in Santos Port

	Total (Millions of tons)	Gross tariff revenues (Millions of Brazilian reais)
2007	81	321
2008	81	323
2009	83	340
2010	96	379
2011*	12	54

* January and February.

Source: Codesp



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Surprising U.S. foreign policy continuity under Obama



Walter Russell Mead and Josef Joffe

Mr. Mead (left) is editor at large of of the journal *The American Interest* and professor of international relations at Bard College; Mr. Joffe (right) is publisher-editor of *Die Zeit* , fellow in international relations at the Hoover Institution, and professor of political science at Stanford University.

Kalinka Iaquinta, Rio de Janeiro

Although a symbol of change even in his skin color, U.S. President Barack Obama has shown that when it comes to international relations, he has not abandoned the policies of his predecessor, George W. Bush. That is the opinion of American foreign policy experts Walter Russell Mead, the Henry A. Kissinger senior fellow at the Council on Foreign Relations, and Josef Joffe, a Stanford University professor,, who in April were in Rio de Janeiro to deliver lectures sponsored by the Center of International Relations of the Getulio Vargas Foundation. Before doing so, they analyzed contradictions between Obama's election campaign promises and his actions in office. They predicted that Brazil would not be a controversial issue for U.S. policy.

The Brazilian Economy **— Mr. Mead, you classify the foreign policy of U.S. governments in terms of the thinking of four U.S. politicians: Thomas Jefferson, Andrew Jackson, Alexander Hamilton, and Woodrow Wilson. Obama would seem to have a Jeffersonian style, avoiding military interventions and favoring the defense of democracy from home. Is that a good characterization?**

Walter Russell Mead — While Obama was running for president, I did classify him as Jeffersonian. He opposed President Bush's intervention in Iraq and said that America needed to return to a more constitutional and more legal approach in its foreign policy. Since moving to the White House, however, he seems to be finding inspiration in

a different tradition: that of President Woodrow Wilson, who advocated promotion of democracy and human rights across the planet. Take the example of humanitarian intervention in Libya. Indeed, it is surprising that the UN Security Council voted in favor of this intervention but it was rejected by the U.S. Congress.

Josef Joffe — Besides Jefferson and Wilson, we see in Obama a bit of George W. Bush: that is a great surprise! The Obama administration continues the wars in Iraq and in Afghanistan, has not closed Guantanamo prison, and has resumed military tribunals for prisoners at Guantanamo, which was something he vehemently opposed as a candidate.

What are the consequences of Obama's positions for the United States and its foreign relations?

Joffe — You have three presidents for the price of one . . . . You have a traditional liberal-isolationist, who follows the tradition of Jefferson; an expansionist-idealist like President Wilson, who believes he can make the world safer through democracy; and the nationalist-activist, the president who believes in applying U.S. military force around the world. No other president in American history has led three military campaigns at once.

How do you assess the president's visit to Brazil and what can we expect from this relationship?

Joffe — The Brazilian media highlighted the visit positively, as President Obama offering deference to President Rousseff by coming to Brazil before she visits Washington. But I think the gesture goes further. It is part of Obama's strategic approach of pressing the reset button. Just as he is trying to do with the Islamic world, with Russia, he is seeking to rebuild the relationship with Brazil, which became a little distressed during the Lula administration. So, it's a clear sign of interest in re-engaging in search of a constructive relationship for both countries, and it goes beyond the symbolic.

Mead — I understand that in the U.S.

"While Obama was running for president, he opposed President Bush's intervention in Iraq and said that America needed to return to a more constitutional and more legal approach in its foreign policy. Since moving to the White House, however, he seems to be finding inspiration in a different tradition: that of President Woodrow Wilson, who advocated promotion of democracy and human rights across the planet." *Walter Russell Mead*

Foto: Credito da foto

thinking about Brazil is growing. There are a number of countries with whom we share values, history, economic interests. Of course, sometimes we have our disagreements, with France on Airbus, say, or with Brazil on ethanol. But I think we believe that a global free trade system is better able to ensure prosperity for the poorest and the population as a whole. And, like the United States, Brazil is demonstrably a country that believes in the idea that democracy brings peace and prosperity. For that reason I think it is natural that President Obama would want to visit Brazil, talk about the future with the president of Brazil, as it must do with the German chancellor and the British or the Japanese prime minister.

"We see in Obama a bit of George W. Bush: that is a great surprise!" *Josef Joffe*

Recently, Obama announced his candidacy for reelection. Could this change the way he conducts U.S. foreign relations?

Joffe — If you asked me that question two years ago, I would say no, not really. But Obama was elected opposing the policies he now continues, such as the war in Iraq and the action in Libya.

"On Brazil the Americans have a clear policy . . . there are no problems about it."

Walter Russell Mead

It is an interventionist foreign policy. Since the campaign, there has been the global economic crisis. . . . Today factors related to the domestic economy will determine Obama's success. I do not believe that issues like Afghanistan, Iraq, or Libya will be as influential in the opinion of Americans in relation to the election.

Mead — With respect to Brazil, I think there will be no changes from the current policy line regardless of who wins the next election. On Brazil the Americans have a clear policy ... there are no problems about it. Some Republicans have criticized Obama's statement that he would like to buy oil from Brazil. But the intention was not to criticize Brazil but to point out a contradiction in Obama's speech, which advocates energy independence but also announces interest in Brazilian oil. Brazil, however, is not a controversial issue for U.S. policy.

What legacy do you expect President Obama will leave?

Joffe — So far Obama has been very flexible. He began his campaign with a leftist agenda, with the promise of transforming the U.S. into a European-style social democracy. Then he garnered three wars, had to manage the Gulf oil spill crisis, and certainly had to give up an ambitious domestic

policy agenda. It is difficult to say what he could do in two more years, let alone six.

Mead — In foreign policy, I can say that his legacy is not what we expected. It is like what happened with President Eisenhower: He was elected in opposition to President Truman, who called for continuing the fight against communism. When he was elected, however, Eisenhower pursued a very similar policy, which helped create a consensus in America about the Cold War. It is possible that, given the continuity between the policies of George Bush and Obama, a new consensus will emerge — not about what Bush did, and certainly not the way he did it, but seeing Democrats supporting a similar policy.

Could you imagine a different Obama in a second term without the problems raised by the economic crisis?

Mead — There is a famous story about British Prime Minister Harold Macmillan. He was asked by a young journalist what can most easily steer a government off course. He replied, "Events, dear boy. Events." If we are speculating about the future with President Obama, we might ask: What will happen, for example, if Iran decides to test a new nuclear weapon? Or if the situation in Syria becomes as serious as in Libya? What should be done if the economic and real estate bubble bursts in China and the world finds itself in a completely different economic situation than we have today? Or if there is deeper recession and unemployment rises sharply in the United States? All this can impact the actions of President Obama. Events will rule actions.

Joffe — Voters do not like extremes. Obama moved to the left, and ended up handing over control of the House of Representatives to the Republicans, losing seats in the Senate. I think that Obama will continue with a foreign policy that is not too interventionist or too isolationist, too idealistic or brutally realistic. He will continue with the pattern of Libya, a bit of military intervention but cautiously and seeking the help of others. He will not take drastic actions if there are no drastic events warranting it.

"Obama is seeking to rebuild the relationship with Brazil, which was a little distressed during the Lula administration." *Josef Joffe*



Energy debate heats up

A seminar on the energy sector in Brazil sponsored by the Brazilian Institute of Economics of the Getulio Vargas Foundation (IBRE-FGV) and *Conjuntura Econômica* magazine on March 28th and 29th in Rio de Janeiro produced brisk debates about the future of the sector.

Solange Monteiro, Kalinka Iaquinta and Thais Thimoteo, Rio de Janeiro

Today's projections for the growth of the Brazilian economy, projections for infrastructure investments, and a booming domestic market suggest that Brazil will be a very different country 10 years from now. For that to happen, however, one production component will be vital: energy. From exploration of deep sea oil to expansion of alternative sources of energy, the country must confront issues ranging from public policy to attracting investments while ensuring abundant energy to keep the economy moving.


Mauricio Tolmasquim


Altino Ventura


João Carlos Mello


Eduardo Chagas

Mauricio Tolmasquim, president, Energy Research Company (EPE), talked about the growing demand, commenting, "Even with an expected drop in the population growth rate — in the 1950s, it was 3% a year and has now gone down to between 0.5% and 1% — over the next four years we will acquire 6 million more inhabitants." And their quality of life will be much higher, which means more consumption, added Altino Ventura, secretary of energy planning and development, Ministry of Mines and Energy. "Per capita GDP will increase an estimated 3% a year and demand for electricity will increase about 4%," he said. Thus, by 2030 power generation in Brazil will have to double. The required investment will be heavy, but Brazil has a great advantage: clean electricity production mainly based on hydropower and an increase of new renewable sources of energy like wind, sugarcane biomass, and natural gas. Ventura noted that 41% of world electricity today is generated by coal, and China is adding 90,000 megawatts a year from new coal-fired plants.

João Carlos Mello, president, Andrade & Canellas Consultoria, was optimistic about attracting investment in Brazilian renewable energy projects because of buoyant demand, good rates of return, and cheap credit. Eduardo Chagas, manager of electric energy, National Bank for Economic and Social Development (BNDES), emphasized that BNDES is supporting energy production with increased participation in projects, longer repayment terms, and lower charges. "It shows that we are serious in the effort to keep electricity rates affordable, which is part of the tripod that guided the design of the electric sector; the other legs are security of supply to the National Interconnected System and the development of alternative sources," he said. From 2003 to 2010, BNDES supported 355 electrical projects, 225 of them for generation, which represented funding of R$74 billion. There are other signs of a sound environment: According to EPE's Tolmasquim, between 2010 and 2014 electricity generated for their own use by consumers (mainly large companies) will grow 5.6% annually, and the gain in electrical efficiency will be 12 TWh, equivalent to about 2% of projected demand for electricity in 2014.


Mozart Siqueira Campos Araujo


Nelson José Hübner Moreira


Reginaldo Almeida de Medeiros


Luiz Fernando Leone Viana

Tomalsquim believes this favorable scenario reflects a greater confidence in the energy system within a market where consumers are free to choose. He cited the energy auctions, which have guaranteed new electricity generation projects, as one example. "Today, 70% of what we need in the next 10 years is already contracted, and power plants are being built in Jirau, San Antonio, and Monte Belo," he said. "Energy is no longer a bottleneck. In 2011 and 2012, considering the surplus in the system, Brazil could grow 7% a year. "

Electricity rates and competitiveness

Yet other experts at the seminar had more critical views and suggested many course corrections to ensure that Brazil's energy agenda will be successful."We need to ensure financial rules, setting prices at auctions, and stable electricity rates," said Mozart Siqueira Campos Araujo, director, Brazilian Association for Clean Energy Generation. Another issue that will require intense debate is renewal of existing concessions, added Nelson José Hubner Moreira, director general, National Agency for Electrical Energy. Reginaldo Almeida de Medeiros, CEO, Brazilian Association of Energy Traders, added, "Now what is most important is to have principles to guide these discussions that promote equality between captive and free-market, speed in decision-making and legal certainty."

Currently, the free market already represents 27% of the national energy total, largely in long-term contracts. Luiz Fernando Leone Viana, president, Association of Independent Power Producers, spoke for incentives to enlarge the free market, arguing that competition is important to ensure balanced prices. He also pointed out that another concern related to generating more electricity is the unresolved controversy of environmental licenses, which have introduced considerable uncertainty about projects meeting deadlines.

While industry suppliers are concerned to generate electricity at competitive prices, both residential and commercial consumers are even more concerned about electricity rates being bearable. "Energy is a recurring theme for formulators of industrial policy, because it will be highly relevant to the composition of manufacturing costs in coming years," said Sergio Quintella, FGV vice president. Paulo Pedrosa, president, Brazilian Association of Large Industrial



Joísa Campanher



Sergio Quintella



Paulo Pedrosa

Energy and Free Consumers, argued that the energy debate should be guided not only by engineering vision but also by the logic of the economy. "Today, the energy debate is dominated by agents, investors, and producers in the energy sector itself, without reference to such items as efficiency and price," he said. "The economic signals are distorted, which brings about poor transparency and lack of competition. What's the result? The consumer is likely to assume the cost of public policies, absorbing inefficiencies by paying taxes."

Pedrosa displayed results from a study in partnership with FGV Projects finding that the taxes and charges on electricity rates in some cases account for half the cost, which reduces the competitiveness of Brazilian industry (see *The Brazilian Economy*, March 2011). To change this situation, he argued for the allocation of the energy of power plants whose concessions expire in coming years to all consumers, captive or free, at prices that reflect plant depreciation already paid; making social contributions non-cumulative at 3.65%; and getting rid of the consumption account of the development account and the global reversion reserve. "With these measures in this decade we could have real economic growth that is 1.2% higher," he said.



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Defense of nuclear energy

Tsunami damage to the nuclear complex Fukushima Daiichi in Japan set the tone for the lively panel discussion on nuclear energy. The big question was whether Brazil should maintain its nuclear program; in January Mines and Energy Minister Edison Lobão had announced plans for construction of four to eight new power plants.

"Our main mission is to show Brazilians how this energy is appropriate and how we can do it safely," argued Luis Felipe da Silva, advisor to the president, Nuclear Industries of Brazil. While all the panelists downplayed the risks of an accident in Brazil, they did not rule out the possibility that global security standards for nuclear power plants would be revised, which might raise costs. " I think there will be new requirements for licensing, but it is an energy that remains safe," summed up Antônio Müller, president, Association of Development of Nuclear Activity.

According to Leonam dos Santos Guimarães, assistant to the president, Eletronuclear, containment measures were being considered even before the tragedy in Japan, including possible installation of a small hydroelectric plant nearby exclusively to supply electricity in case of total loss of energy from a nuclear power plant. "We're checking up on capability to mitigate adverse events," he said.

Carlos Figueiredo, advisor to the commercial department, Nuclebrás Heavy Equipment, noted that Brazil and Japan use different nuclear-power-plant technologies. New plants in Brazil will use third-generation reactors, the cooling of which is independent of internal or external power. "For emergencies, these plants will incorporate passive safety systems, where there is no human intervention," he said.

Da Silva argued that the country needs to invest in producing the complete cycle of uranium; today, two of the five stages are handled in Europe. "We believe that by 2018 everything will be done here; we have already mastered the technology," he said.



Luis Felipe da Silva



Leonam Guimarães



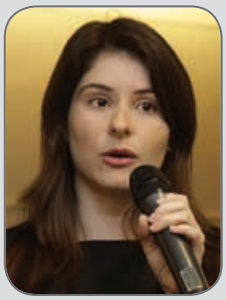
Antônio Müller



Carlos Figueiredo

Green energy


Odacir Klein


Nayana Rizzo

Ethanol and biodiesel, it was agreed, have taken a larger share of the Brazilian energy sector, and the market for them is growing. Biodiesel already constitutes 5% of diesel oil. According to Odacir Klein, president, Brazilian Biodiesel Union, the big goal now is to diversify the raw materials used — soybeans are now the largest biodiesel source.

Ethanol use has expanded remarkably due to the increased prevalence of flex cars that run on either ethanol or gasoline, "Brazil already consumes more ethanol than gasoline," said Nayana Rizzo, director of institutional relations, Union of the Sugarcane Industry (Unica). Now the industry hopes that more fuel will be generated from sugarcane. "At present, only 23% of sugar cane plants are selling electric energy," said Zilmar José de Souza, manager, Unica Bioelectricity. "With the current production of cane and with the retrofit of plants already installed, by 2014 we could generate 9,000 MW per year — one and a half times what the Belo Monte plant produces."

Sun and wind


Ary Vaz Pinto


Ricardo Simões


Marco Antonio Galdino

Experts cited two moments when the winds became favorable for development of wind energy in Brazil. The first, said Ary Vaz Pinto, head of special technologies, the Center for Electric Energy Research, was the Program of Incentives for Alternative Electricity Sources in 2002, which used guaranteed prices to encourage enterprises. "Then in 2004 came the concept of affordable tariffs, when subsidies were cut and the wind power sector had to prove it could be competitive."

The second pivotal moment was the economic crisis of 2008. Ricardo Simões, president, Association of Wind Energy, pointed out that the financial meltdown in developed countries has reduced demand, made equipment cheaper, and caused the Brazilian real to appreciate. But "these advantages in the international environment will not last, so we must work to make wind power more competitive."

Pinto thought the prices at energy auctions in 2009 and 2010 surprised the market, reaching R$123 per MW hour in 2010 and demonstrating the growth potential of wind power. It is estimated that in Brazil, at a reference height of 100 meters there would be electric generation potential of 300 GW, an immense value considering that wind generation projected for 2013 is just 5.25 GW. "We have everything in Brazil: tower manufacturers, components, consultants, and builders," Pinto said.

As for solar energy, Marco Antonio Galdino, regional representative, Association of Solar Energy, stated that its generation in Brazil is still limited, around 30 MW, mainly from the Light for All Program, which provides photovoltaic cells for households in remote regions. "World demand is good, with subsidies and incentives in countries like the United States, Japan, and Spain," Galdino noted, pointing out the potential of intelligent electric grids, where a solar-powered house can also provide energy to the grid for payment. Since Brazil is far from that point, Galdino said that the best strategy is to invest in technology. "We are the third largest producer of silicon [the main material in photovoltaic cells], but we export it impure," he said. "We should examine the feasibility of processing it here and develop cutting-edge technology for this market, which is growing."

Oil: The great treasury

The dynamism of the energy sector in Brazil is most evident in oil and gas, thanks to deep sea oil. Altino Ventura, energy expert of the Ministry of Mines and Energy, said that the country will in coming years transition from a small importer of energy to an exporter. "Today we import 5% of the total energy we need, from Itaipu, Bolivian gas and some coal," he said. "According to the 10-year plan for energy, we will soon produce 5 million barrels a day, and consumption is just 3 million a day."



Altino Ventura



Luiz Eduardo Dutra



Tuerte Amaral Rolim



Werner Grau

Tuerte Amaral Rolim, Petrobras executive manager of exploration and production, said that increased production — 7.1% a year in this decade, compared to 5% in 2002–2010 — will be a great opportunity for building various links in the supply chain. "This is a massive opportunity for Brazil's technological and scientific development," he said.

"Over the past 10 years the country has rebuilt the oil and gas sector; now we need to keep up the same pace and explore the new oil fields," said Luiz Eduardo Duque Dutra, chief of cabinet, National Oil, Natural Gas, and Biofuels. For Dutra, the priority now is to authorize the eleventh round of bidding for exploration of new fields. Of the many related challenges Armando Guedes Coelho, counselor, Federation of Industries of Rio de Janeiro, gave priority to financial issues, technology, and especially training skilled employees.

Werner Grau, partner, Pinheiro Neto Advogados, noted that deep sea oil will be subject to criticism as part of international discussions on climate change because it will increase the share of fossil fuels in Brazil's energy mix. His recommendation is to revive a bill allowing companies exploring deep sea oil to earn carbon credits to offset emissions by preserving a forest area.

Generating heat: Gas and coal

The gas potential associated with deep sea oil is a major driver for redefining the role of thermal plants in the Brazilian energy sector, experts told the audience. "We have to drop the idea that electricity supply can only be expanded by increasing hydroelectric power," said Xisto Vieira, president, Association of Thermoelectric Generators. Among the advantages of thermal generation, he said, are the speed of construction and the advantage of flexible location, with lower transmission cost. "Thermoelectric generation avoids transmission losses and can quickly adapt to sudden increases in electricity demand, which is important for ensuring that the electric system is reliable," he said.



Edmundo Alfredo Silva



Hermes Marques



Renato Costa



Fernando Luis Zancam



Tathiany Moreira



Wilson Yamaguchi

Currently, natural gas accounts for about 10% of the Brazilian energy matrix. Renato de Andrade Costa, Petrobras general manager of energy business, is optimistic about that percentage rising. "Thermoelectric generation can supplement hydroelectric generation. The latter has a high capital cost but a low variable cost, while thermoelectric power has a low investment cost and a high variable cost," he said. "So thermoelectric can function like insurance, to be used when hydroelectric reservoirs are low." Also, Costa suggests, "Maybe in the future we should have an auction just for gas, separate from wind and other sources, because they have different characteristics."

Tathiany Moreira, assistant director-general, National Agency for Petroleum, Natural Gas and Biofuels, praised the gas law passed late in 2010, calling it "a breakthrough for the industry because it strengthens the role of the regulator; it specifies new factors that the regulator can act on. The issue is to determine transport tariff and continue bidding the concession contracts and construction of new pipelines."

Despite the environmental impact of carbon dioxide emissions, representatives of the industry argued for the need to keep coal-fired generation in the Brazilian energy mix, and the benefits of doing so. Today, 90% of known reserves are in Rio Grande do Sul, of which 40% are in Candiota city, where earlier this year after more than 20 years of waiting the third coal-fired power plant began operating commercially. Hermes Marques, project manager, Eletrobras Thermal Generation of Electric Energy Company, considers this a special achievement because "This coal has low calorific value, which does not justify the cost of moving it; it should be used in the same region."

Fernando Luis Zancam, president, the Brazilian Coal Association, stated that throughout the world coal-fired generation should grow 90% by 2035, driven by Asian energy demand. He defended resumption of the search for new Brazilian reserves with an appropriate program of geology and highlighted technological advances that help coal-fired plants to pollute less. He pointed out that in Brazil emissions are mainly from land use and agriculture; electricity accounts for only 1.5%. Wilson Yamaguchi, manager of engineering for MPX, said that MPX's plans for expansion project include three coal-fired thermal plants. MPX, which has coal operations in Colombia and Rio Grande do Sul, plans to invest R$4 billion by 2012 in electricity production.

The governance of public institutions



Fernando de Holanda Barbosa

The principal-agent theory seeks to explain how the principal (the voter, for our purposes) can design a contract in which the agent (the politician) acts on behalf of the principal's interest, not the agent's. Usually there are conflicts of interest between the two parties; and information is not always symmetrical. The agent knows what he's doing, but the principal is not in a position to comprehensively monitor the agent's behavior.

The theory helps to explain some problems in the governance of three public institutions in Brazil: state enterprises, pension funds, and the State Guarantee Fund for Length of Service (FGTS). Since the early 1980s management positions in state enterprises have become the currency of exchange for political support in municipal, state, and federal governments. Competition for jobs is fierce, and the allotment of those in state enterprises by political parties is an everyday occurrence. Is this type of governance good for the country? In the current arrangement, the principal (the executive branch) chooses the agent (the board of the enterprise) in terms of political criteria for distributing positions among parties supporting the government.

Professor at the School of Graduate Studies in Economics of FGV.

It could be argued that this type of procedure is natural in a democracy, because the responsibility of government falls on the parties participating in a coalition government. However, the real question is: Should state-owned enterprises be pursuing different policies for each government? Or should they by their very nature (oil, electricity, banks, etc.) have a longer time horizon? And therefore a form of governance that would prevent their misuse by political parties? If the answer to the first question is no and the second is yes, state-owned enterprises cannot belong to the executive branch, as they do at present; nor should the agents (the board) be nominated by the parties. We must seek a solution that makes state-owned companies actually follow best management practices independent of political parties.

The pension funds for employees of state enterprises (Previ, Banco do Brasil, Petros, Petrobras, etc.) belong to those employees. Therefore, the employees should choose the directors of these entities (agents), who should protect their interests. Yet in practice pension fund directorships have become political, and government interference is heavy.

Take as an example the recent case of the Vale Company. Vale is controlled by Previ, the pension fund for Banco do Brasil employees. According to media reports, the government wants to replace Vale's current CEO. The question here is: Would replacing the Vale CEO meet the interests of Banco do Brasil employees? If the answer is no, there is something wrong with the way pension funds are currently managed. We must find a solution that makes these pension funds really belong to state employees.

FGTS, a fund that belongs to the workers, is almost a case for the police: it has had a negative real yield for years. Why do the principals (the workers) not dismiss the fund's managers on grounds of irresponsibility? If you think principals should fire agents, FGTS governance must change so that FGTS actually belongs to the workers.

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