# THE BRAZILIAN ECONOMY

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## Insurance A RACE FOR GROWTH

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The BRAZILIAN ECONOMY

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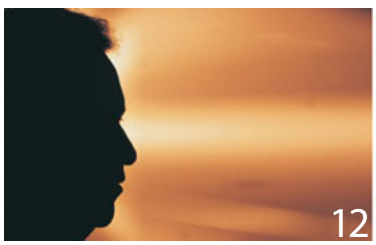
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# THE BRAZILIAN ECONOMY










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"Is Brazil still a global trader?" Lia Valls Pereira asks. Though the answer is yes, the structure of world trade has changed, so the search for new opportunities, better infrastructure, and reduction in administrative costs and the tax burden must remain policy priorities.

## FOREIGN POLICY

### Trade exchanges between China and Brazil

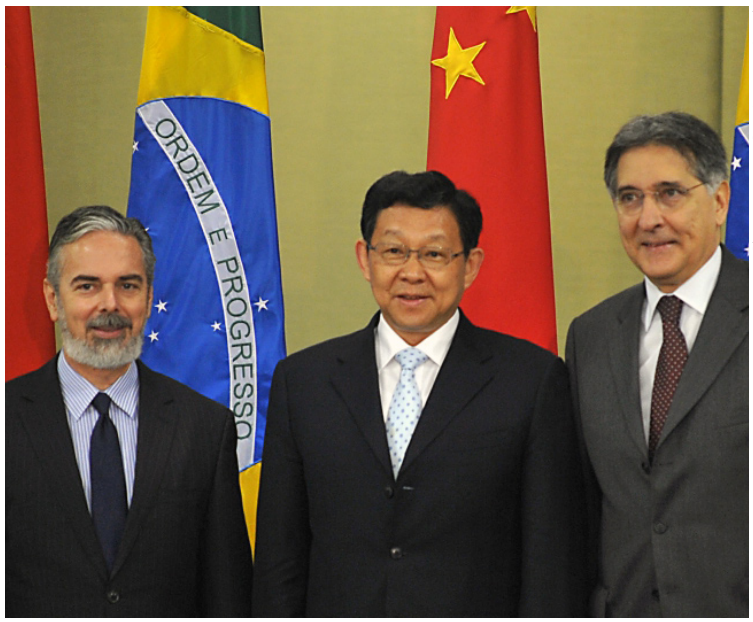



Photo: Antonio Cruz/Agencia Brasil.

Minister of Foreign Affairs Antonio Patriota (left), China's Commerce Minister Chen Deming (center), and Minister of Development, Industry and Foreign Trade Fernando Pimentel.

Though Brazilian manufacturers claim that the Chinese currency is much undervalued, undermining their competitiveness, on her visit to China President Rousseff did not raise the issue, though she signed new contracts that give Brazil greater access to Chinese markets and investment pledges that may ease trade tensions. Chinese companies have reached agreements for US$1 billion investment in projects in Brazil. (April 12, 2011)

After the president's trip, a Chinese trade mission headed by Commerce Minister Chen Deming and representing over 40 agribusiness, telecommunication, contractor, bank, and railway companies, visited Brazil. Some companies in the delegation, such as Huawei and ZTE, already have operations in Brazil; others are studying the possibility. Minister Chen met with Minister of Foreign Affairs Antonio Patriota and Minister of Development, Industry and Foreign Trade Fernando Pimentel. (May 16, 2011)

### BRICS advocate UN reform

At the third annual BRICS summit leaders of the five members — Brazilian President Rousseff, Russian President Dmitri Medvedev, Indian Prime Minister Manmohan Singh, Chinese President Hu Jintao, and South African President Jacob Zuma — issued a statement for the first time asking explicitly for changes to make the United Nations Security Council more representative of the membership. China and Russia are already permanent members of the Security Council (April 14, 2011)

## POLITICS

### Opposition parties talk about merging

Talks about merging opposition parties were prompted by fears that they may lose more members to the PSD, recently created by the mayor of São Paulo, Gilberto Kassab, who left the DEM. Former President Fernando Henrique Cardoso also acknowledged that there is a possibility of a merger between the PSDB and the DEM, but stressed that talks are "preliminary." Opposition leaders argue that any decision should be taken after the municipal elections in 2012. (April 28, 2011)

## ECONOMY

### Supermarket sales grow 9.3% in March

According to the Brazilian Association of Supermarkets (Abras), after retreating in real terms by 21.1% over the previous month in January and by another 7.1% in February, supermarket sales grew by 9.8% in March over February. (April 28, 2011)

### March industrial production data higher than expected

Industrial production grew 0.5% month-to-month in March, well above the consensus forecast of 0.2%, bringing cumulative growth in industrial production in the first quarter to 2.8%, confirming some analysts' expectations of heightened domestic demand. (May 3, 2011)

### Dollar inflows exceed outflows in April

More dollars entered Brazil than left in April, producing a positive balance of US$1.5 billion. The balance, however, was substantially

lower than in previous months, before government measures to curb dollar inflows. On March 29, the government raised to 6% the tax on financial operations for loans up to one year taken abroad by Brazilian companies and banks, which increased substantially the cost of short-term operations. (May 4, 2011)

### 12-month inflation hits 6.5%

The Broad Consumer Price Index rose by 6.5% year-on-year according to the Brazilian Institute of Geography and Statistics, near the top of the target range (2.5%–6.5%). Shortages of alcohol raised fuel prices, more than offsetting a slowdown in food prices. (May 6, 2011)

## BUSINESS

### Brazil moving to privatize airports

The Brazilian government is privatizing the country's five largest airports for fear that the transport infrastructure will not cope with the influx of visitors for the 2014 World Cup and the 2016 Olympics. In May auction terms will be announced for Guarulhos airport in São Paulo, the Juscelino Kubitschek airport in Brasília and the Campinas airport in São Paulo state and in early July for Galeão airport in Rio de Janeiro and Confins airport in Belo Horizonte (May 3, 2011).

## ECONOMIC POLICY

### BNDES CEO calls for action to curb the rise in the real

Appreciation of the Brazilian real can cause problems for the economy, said Luciano Coutinho, the CEO of National Bank for Economic and Social Development, during President Rousseff's visit to China, concluding that "We have to … help protect the Brazilian economy from short-term speculative activities that [exacerbate] currency appreciation." (April 12, 2011)

### Mantega: Inflation and exchange rate measures should be gradual

Meeting with investors in New York Finance Minister Mantega said,"We cannot … take excessive measures [to curb inflation] in the short term because it can tip the economy," but pointed out the government has taken steps to slow economic growth to a sustainable pace. In 2011 he expects an increase of about 10% in investment and a nominal deficit of about 1.7% of GDP. (April 18, 2011)

In testimony before Congress Mantega also said that the Brazilian real would have appreciated to 1.4 against the US dollar without central bank interventions and a rise in the tax on capital inflows. The real trade-weighted effective exchange rate of the real has risen by only 0.3% since 2010 (May 3, 2011)

### Benchmark rate goes up

The central bank has raised its benchmark interest rate by 0.25 percentage point to 12% a year and said that rises will continue because "adjustment of the monetary conditions for a sufficiently long period is the most appropriate strategy to ensure convergence of inflation to the [mid-point] target in 2012." (April 25, 2011)

### IMF to Brazil: Act now to avoid overheating

Brazil risks overheating sooner than its regional peers if the government fails to rein lending and inflation, warned Miguel Savastano, deputy director of the IMF Western Hemisphere Department. "If this [expansionary] policy continues until the end of the year, it is unlikely that the Brazilian economy would slow down ... That could generate worrisome imbalances," he told reporters. Savastano agreed with the central bank that Brazil is likely to miss its 4.5% mid-point inflation target this year. (May 4, 2011)

## EDUCATION

### President says technical education can lessen poverty




Photo: Jose Cruz/Agencia Brasil.

President Rousseff launches the National Program for Access to Technical schools.

President Rousseff stated in April that Pronatec (National Program for Access to Technical Schools) will be a gateway to prosperity for Family Grant beneficiaries because Brazil will need qualified workers to meet the new development cycle. She and Education Minister Fernando Haddad announced that by 2014 over 200 technical schools will be built, 80 in the next year. (April 28, 2011)

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# A delicate dance with China

*Brazil needs China. China needs Brazil. But is mutual need enough to ensure harmony? Or will both countries be dancing to different tunes?*

Officially, Brazil regards China as a crucial consumer of its goods. And in the G20 and the BRICS club, among other multinational efforts, the two countries are also engaged in common global initiatives. An effective partnership should fit neatly into the Brazilian's Workers Party's South-South cooperation agenda. But how close are these "partners"? And just how effective is this partnership?

President Rousseff had a productive trip to China for meetings with its leaders and for the BRICS summit. She and President Hu Jintao signed 20 deals on everything from defense to the environment. But there remain concerns about trade. For instance, there is a qualitative imbalance in that nearly 80% of Brazil's exports to China are raw materials like oil and soybeans, while 90% of China's exports to Brazil are manufactured goods. Our Politics contributing editor João de Castro Neves thinks this looks more like the old-fashioned North-South relationship. And while Chinese firms are investing in Brazil, some Brazilian companies are not having an easy time with their investments in China. Beijing recently turned down Embraer's request to build its E-190 jet at its joint venture plant in China for fear the E-190 would compete with Chinese plans to build regional jets. And because of mounting complaints from trade unions and industrial groups, Brasilia has passed a large number of anti-dumping measures this year against Chinese goods.

There are still plenty of common interests to keep Brazil and China dancing to the same tune. But each country must take some care to avoid forcefully stepping on the other's toes.

As for common global initiatives, China, a permanent member of the U.N. Security Council, has not been willing to endorse Brazil for a permanent Security Council seat, though after this year's summit, the BRICS group of which both China and Brazil are members did issue a statement for the first time asking explicitly for changes to make the Security Council more representative. But there are other areas, such as development of renewable energy, where the two are at opposite ends of the spectrum of options. Exchange rates are likely to rise on the Brazilian economic agenda. And President Rousseff has made it clear, though not directly in relation to China, that human rights will be one of her signature issues.

But Brazil and China do have some common issues to deal with, as China's new five-year plan for 2012–2016 makes clear. China plans to restructure its economy to create more sustainable growth and deliver the fruits to more of its people. Brazil has made a good start in that direction already, but we should always be willing to learn if China comes up with new and replicable ideas. Both countries have to decide what to do about bank interest rates and extending access to credit. And both share a similar major challenge: what to do to keep inflation in check. There are still plenty of common interests to keep both countries dancing to the same tune. But each country must take some care to avoid forcefully stepping on the other's toes.

# China and Brazil relations: Beyond carrots and sticks

*The established official Brazilian perspective regards China not only as a crucial importer of our goods but also as a key player in Brazil's global diplomatic strategy. Nevertheless, there are several questions about the future of the Brazil-China partnership.*

**João Augusto de Castro Neves**

For almost a decade now trade relations with China have been an important motor of economic expansion in Brazil. The total bilateral trade exchange (exports + imports) saw exponential growth since 2003, from nearly $7 billion to $56 billion in 2010. In fact, last year, China became Brazil's main trading partner, surpassing the United States. It is also noteworthy to mention that throughout most of that time Brazil has enjoyed significant trade surpluses with China (except in 2007 and 2008, when trade flows favored China).

But China's importance to Brazil seems to have gone well beyond the economic realm during the same period. President Lula's inauguration, in 2003, brought to power not only a left-wing government, but also a party – the Workers' Party (PT) – with a clear foreign policy agenda. Aimed at strengthening Brazil's relations with other developing countries, the so-called South-South cooperation, the Lula administration approached China as a possible partner for broader political and strategic objectives, such as the pursuit of a multipolar international order – that is, an order centered not so much around Western powers, namely the United States.

Consequently, the established official Brazilian perspective regards China not only as a crucial consumer of goods but also as a key player in Brazil's global diplomatic strategy. Several coordinated efforts on the global stage underline this importance. Both countries play significant and related roles when it comes to agricultural issues in multilateral trade negotiations (G20+); in climate change talks (BASIC); in deliberating on the new architecture of the international financial system (G20); and in setting up a coalition of emerging powers that allude to a new and more representative world order (BRICS). Needless to say that, without China, these groupings would be less meaningful if nonexistent.

In light of this, it came as no surprise that President Rousseff decided to visit Beijing at an early stage of her administration – last April's trip was her third abroad since inauguration in January. Confirming China's newfound place among Brazil's top foreign policy concerns, Ms. Rousseff signed with President Hu Jintao nearly twenty deals, ranging from defense-related matters to trade, environment and technological cooperation. Her trip to China was also an opportunity to strengthen ties with other emerging nations at the 3rd summit of the BRICS (Brazil, Russia, India, China and newly-anointed member South Africa).



Photo: Roberto Stuckert Filho/Agência Brasil

Presidents Dilma Rousseff and Hu Jintao: A difficult but indispensable partnership.

The two emerging powers believe that they should play a more prominent role in global affairs, but they do not necessarily agree on what a more representative or just global order should look like.

## Conflicting interests

Despite some palpable results, Ms. Rousseff's trip still leaves several important questions on the future of Brazil-China relations unanswered. Going back to the economic realm, concerns with possible negative externalities of the bilateral exchange are on the rise. When it comes to trade, for example, there are two main concerns. First, the obvious qualitative imbalance of the trade: while nearly 80% of Brazil's exports to China are basic goods (iron ore, soy beans and oil), over 90% of Brazil's imports from China consist of manufactured goods, a genuine North-South relation. Second, with a more aggressive trade policy abroad, China has become a threat to Brazilian manufactured goods in third markets, especially in Latin America and in the United States. As a result, there is a mounting perception that growing economic interdependence does not rule out dangerous asymmetries – to China's favor – that tend to fuel the fear of deindustrialization of the Brazilian economy in the long term.

On the political camp, to affirm that these

The PT-led administration's excessive optimism with the "strategic partnership" should not backlash into an also ideological and counterproductive anti-China stance.

two emerging powers believe that they should play a more prominent role in global affairs is not the same as saying that both countries hold a common view on what a more representative or just global order should look like. China's reluctance to endorse Brazil's bid for a permanent seat in the United Nations Security Council is but one example of this. Other disagreements are likely to surface in the long run, as the two countries are pressed to position themselves with regard to human rights and nuclear proliferation. Even areas where some degree of bilateral coordination exists today, such as climate change, are not immune to future divergences – although labeled as developing countries and listed among the world's top producers of greenhouse gas emissions, Brazil and China are on opposite ends when it comes to the development of renewable energies.

That said, the shortfalls that are likely to result from a more comprehensive bilateral relation should not trump the efforts to try to understand what China means to Brazil in the 21st century. The PT-led administration's excessive optimism with the "strategic partnership" should not backlash into an also ideological and counterproductive anti-China stance. In a sense, history may provide some clues for Brazil. In the beginning of the 20th century Brazilian leaders foresaw not only the rise of a new great power, the United States, but also the need to combine different forms of engagement as well as to maintain with other established and emerging powers the foundations of a more balanced foreign policy strategy. Hedge is the word.




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# The trajectory of an enterprising Union

Since the foundation, in December of 1968, the Union of Heavy Construction Industry of the State of São Paulo (SINICESP) jumped in the great adventure of progress with the strength of work and the determination of their founders and directors.

Besides the services the entity provides to its members promotes courses, talks and discussions about relevant subtitles in the heavy construction sector. Among the years, the legal and technical departments had obtained a lot of important victories for its members.

SINICESP has become a national reference for its quality. Among these times, its has presented very clear objectives with technical studies willing to rush and help São Paulo's and Brazil's development.

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SINICESP

UNION OF HEAVY CONSTRUCTION INDUSTRY
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# Cardoso and the frustrated new middle class

Former President Fernando Henrique Cardoso walks a tightrope. As a politician, he has continued to exercise vigilance so that his words do not escape the narrow sense that his sociological persona usually gives them and enter the emotional and shallow arena of partisan acrimony. Recently, though, the politician dozed off and let the sociologist score a goal with a provocative article[1] that caused exactly the reaction social scientists should seek: to provoke debate.

The article was about the challenges facing the opposition given the overwhelming dominance of the Workers' Party (PT). One fateful phrase stood out: "As long as the PSDB and its allies continue to compete with the PT for influence on 'social movements' or the populace, that is, on the masses of poor and poorly informed, they will talk to themselves."

Taken out of the dense reasoning of the article the phrase quickly ended up on the Internet and social networks, where "the prince of sociologists" was bitterly criticized for his supposed elitism. Anyone who bothered to read the entire article, however, could see clearly that it was dealing with a theme that no party, not just the PSDB, can escape in the future.

The thesis can be summarized simply: with the social mobility that has characterized the years of economic bonanza since 2004, the center of gravity of Brazilian politics, which with democratization had descended from the upper middle class to the popular classes, has begun gradually to climb back up the social pyramid.

The working class and the underclass (those below the poverty line) have shrunk in absolute terms while the lower-middle class has expanded

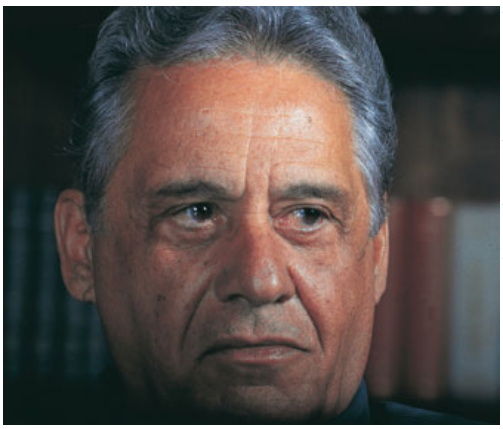


Photo: Fabio Pozzebom/Agencia Brasil.

FHC, the sociologist, scores a goal with a provocative article.

to include most Brazilians. But there has also been considerable movement of the lower-middle class to the middle class and from the middle class to the upper class. In short, the center of gravity is indeed moving upward. Soon political parties will have to deal with Brazilian families who experienced poverty in previous generations but now assume the mentality, tone—and demands—typical of the middle class.

The dialogue will not be easy. The same structure and policies that the democratic state, under pressure from the electorate, built to promote social progress can later frustrate the aspirations of the emerging middle class.

Since the 1988 constitution, and especially since

The same structure and policies that the democratic state, under pressure from the electorate, built to promote social progress can later frustrate the aspirations of the emerging middle class.

[1] Fernando Henrique Cardoso, "O papel da oposição," *Interesse Nacional*, April-June 2011.

stabilization in 1994, Brazil has been building a social welfare state. The country has universal basic education, health and retirement pensions, unemployment insurance, the family grant, and many other social programs. Crowning all is the extremely expensive policy of pushing up the minimum wage, which has doubled in real terms in the past 15 years.

This model has allowed for mediocre economic growth (for an emerging country), though better than in the recent past and with the advantage of better distributing income. What prevents more rapid growth is a high tax burden and low domestic savings compared to other fast-growing countries.

In this context, a newly affluent middle class is emerging, as demonstrated by the surge in air travel. Higher incomes and more affordable credit have given the new middle class access to a variety of durable goods. The lower-middle class, too, has gone shopping, furnished houses, and bought flat panel TVs; some even own a car.

When they leave the house, however, the same citizens are prey to deep discouragement caused by potholed streets, poor transportation systems, a degraded urban environment, poor or nonexistent sanitation, lack of public security, etc. Soon, they will also feel the weight of the choice to accept mediocre growth. After having catapulted from poverty to a far better socioeconomic environment, they will realize that the labor market is not dynamic enough to continuously push them up to the upper-middle class.

They also observe that the social programs for which they voted have become remote, benefitting people at a social level much lower than theirs. Even the annual rounds of minimum wage raises will impact their standard of living less as they move up the income scale.

After having catapulted from poverty to a far better socioeconomic environment, the emerging middle class will realize the labor market is not dynamic enough to continuously push them up to the upper-middle class.

Perhaps with some resentment the new middle class will find that one of the main avenues of social mobility is virtually closed to them: public employment. The children of the emerging middle class, poorly educated in public schools, will be competing with the children of the "old" upper middle class, trained in the best private schools and universities, for the few positions available in the public sector.

It should therefore not be surprising if the emerging middle class gradually changes its perception of the government from being a "father of the poor" to being a burden that they must carry. As their interests align more with the private sector, that class may come to see the world with more market-oriented liberal lenses.

The problem, however, is that the very assumptions of social democracy — that the welfare state has higher priority than wealth and prosperity, for instance — make it difficult to meet the demands of the emerging middle class. With mediocre growth and a public budget drained by expensive social programs, how can the labor market further promote upward mobility, and how can the government invest heavily in urban infrastructure?



# Insurance A RACE FOR GROWTH

**Solange Monteiro**, Rio de Janeiro

Brazil is one of the most promising markets for insurance in the world. Agriculture and other businesses, not to mention individuals, are seriously under-insured. Insurers and reinsurers in Brazil are responding to the country's needs by designing innovative products for everyone from favela-dwellers to the government.

Insurers are waiting for the green light to introduce new products in Brazil, one of the most promising world insurance markets industry. Regulations are expected later this year for micro-insurance and pension plans tied to health, for instance.

According to the Confederation of National Insurance (CNSeg), since 2009 on average market growth has been triple GDP growth. If GDP growth and economic stability continue, in 2011 sales of health insurance, and pension plans should reach about R$205 billion.

Today's insurance market represents 3.5% of GDP. In mature markets like the United Kingdom it is 13% of GDP, according to Max Thiermann, Allianz Insurance CEO. Last year Allianz collected R$2.1 billion in premiums in Brazil, 13% more than in 2009. Brazil is the company's fourth largest market. Thiermann says, "We already have in our portfolio insurance of engineering risks for [World Cup] stadiums like the Mineirão in Belo Horizonte, the Arena do Grêmio in Porto Alegre, and the Kleber Andrade in Vitória. "This year Allianz intends to give special attention to insurance for cars, homes, and small and medium enterprises.

## NEW REALITY

In mature markets the industry does not expect to return soon to the growth and profitability it recorded before the 2008 crisis. A study of 70 large insurers released in March by consulting firm Accenture found that future revenue growth for insurance companies is likely to be concentrated in emerging countries. Since the industry in India was liberalized in 2000, for instance, it has grown 600% and continues to take advantage of the social security gap; it expects double-digit expansion there for the next five years. In India, five companies control 80% of the market; in Brazil, ten companies do so. In China, between 1990 and 2009, the sector's annual growth was 26%, concentrated as in Brazil in local banks.

According to Marco Antonio Rossi, CEO of Bradesco Seguros, the Brazilian market leader with sales of R$ 30 billion in 2010, "Since 1990, we have worked with stable rules and controlled inflation, and so we have great prospects

A study of 70 large insurers released in March by consulting firm Accenture found that future revenue growth for insurance companies is likely to be concentrated in emerging countries.

In a 2008 study, the World Bank noted that while growth in an economy is an invitation to expand the insurance industry, healthy development of the insurance market also helps countries grow.

…. There are many opportunities, from the new middle class to the large universe of small and medium enterprises that do not provide either health or life insurance to employees."

"And Brazilians are relatively under-insured. Fernanda Chavez, coordinator of statistics and actuarial studies at CNSeg points out that unlike in Brazil "a doctor in the United States does not act without a liability insurance policy." André Portela Souza, EASP / FGV economist, gives another example: In the agricultural sector, he says, the government policy of guaranteed minimum prices "creates distortions in resource allocation; it would be more efficient to have insurance tailored for each type of event."

Nikhil da Victoria Lobo, Swiss Re head of public sector business for the Americas, visited Brazil in April to offer the government customized solutions of a type the company introduced four years ago when it insured the Mexican government against earthquakes. "We already have contracts with 15 governments—federal, state, and municipal—to cover ten different types of risk," he says, among them agricultural risks in Vietnam and pandemics in other countries. Swiss Re is now designing policies to cover longevity in pension systems.

In a 2008 study the World Bank noted that while growth in an economy is an invitation to expand the insurance industry, a healthy insurance market also helps countries grow. (The study analyzed the performance of 55 economies between 1976 and 2004.) Mitigating risks promotes stability, and more efficient management of risks stimulates accumulation of new capital and more efficient allocation of domestic savings.

This virtuous circle, the World Bank study says, also involves the financial system. The risk protection offered by insurance encourages the banking system to save by reducing the cost of capital to companies. And, depending on how each country regulates insurance, its activity, especially in life insurance, boosts stock markets.

## MICROINSURANCE

Later this year Congress is expected to pass regulations for selling life (including funeral assistance), home, and personal accident policies to those of lower income

(microinsurance). The market is estimated at 100 million people.

A 2009 study by the FGV Center for Social Policy points out that even where a government offers more abundant social insurance than countries of similar income, it cannot respond to unique individual needs. Supplementary private insurance could absorb shocks and maintain a family's standard of living. Between 2003 and 2009, 27 million Brazilians moved up, into the upper, middle, or lower-middle class, and 24 million broke out of poverty. Once this market develops, says FGV economist Souza, social insurance mechanisms might be modified "so that everyone is free to choose depending on their risk aversion. "

For this potential to be realized, however, Jorge Hilário, president of CNSeg, says that market regulation needs to ensure simplified processes and an efficient system to distribute low-cost insurance products to geographically dispersed buyers. He also insists that "it is important to ensure more efficient taxation, from the cost of the policy to the inspection fee, because today there is no differentiation by segment."

The microinsurance bill Congress is considering would reduce rates to 0.53% for PIS/ PASEP and Cofins[1] compared to 4.65% on traditional insurance policies (except life), which are also subject to a 7.38% financial operations tax (IOF). Because the industry recognizes that not all the risks of doing business with the emerging middle class are yet known, many companies have already begun testing the waters. Late in 2010 SulAmérica launched a product costing R$3 (US$1.8) a month with benefits of R$7,500 for accidental death; it is sold through the Redetrel. "Our goal is to sell an average of two insurance policies a day at each [of about 6,000] vending points", says Renato Russo, vice president of the SulAmérica life insurance and pensions division. The intent is to begin a relationship with the insured and then expand the range of services offered.

Low-income Brazilians "want to persist in their achievements," says Eugenio Velasques, director of Bradesco Vida and Previdência. "However, while the

The risk protection offered by the insurance industry encourages the banking system to save by reducing the cost of capital to companies.

[1] PIS/PASEP and Cofins are federal contributions designed for funding social security.

Later this year Congress is expected to pass regulations for selling life (including funeral assistance), home, and personal accident policies for those of lower income (microinsurance). The market is estimated at 100 million people.

high-income group behaves similarly whether they are in Recife or São Paulo, low-income group behavior is more diverse. You cannot compare the countryside with the suburbs of Rio de Janeiro, for example."

Bradesco Seguros is now working on two fronts. Late last year, it launched home insurance against lightning, fire, and explosion for residents of the Morro Dona Marta favela in Rio. The cost is just R$9.90 (US$6) a year and the maximum benefit is R$10,000 (US$6,000). The product is the result of an agreement between CNSeg and the International Labor Organization (ILO). Last March, the company also launched a policy for accidental death costing R$3.50 a month (US$2) with coverage of R$20,000 (US$12,000). Velasques says that in the Rocinha and Heliópolis favelas the company has sold 750,000 policies. He believes its success depends more on educating insurance sales agents than on marketing.

## UNION OF FORCES

The burgeoning private pension and health segments hope to come together to gain market share this year. In 2010, individual pension plans brought in R$46 billion in new deposits, 19% more than in 2009, and 12 million contracts were written. Health plans have also shot up almost 50% since 2000, from 30.7 million members to 45.6 million, mainly because of the increase in formal employment: 74% of health plan members are linked to collective bargaining plans.

The National Health Agency (ANS) is reviewing a plan that would invest part of the monthly payments in a fund to cover health expenses after age 60. According to the ANS the number of elderly, who now represent 10% of the population and 25% of health spending, is expected to triple by 2050. Another health plan model is a savings account that would offer high-risk insurance coverage for surgeries and hospitalizations.

These alternative health plans "are an incentive to save more and will be tax-exempted, as are retirement savings products," says SulAmérica's Russo, who is also vice president of the National Federation of Private Pension and Life Insurers (Fenaprevi). Some, however, have reservations.

Carlos Suslik, who coordinates the MBA in Health Management of the Institute of Education and Research, comments that "with pension plans the person that receives the benefit is the same person that pays the premiums. Since it is impossible to predict how much it will cost to treat a disease, health plans [on the other hand] pool contributions from many to pay for the health care of some."

## GETTING PAST THE BARRIERS

Discussions on alternative strategies for new markets are natural, experts say. They note, however, that the government has to establish clear and stable rules to foster a sound market—unlike the experience of the reinsurance market.[2] In 2008 elimination of the monopoly of the Brazilian Reinsurance Institute (IRB) attracted many foreign operators interested in large infrastructure projects. What happened then, however, was that the Private Insurance Agency (Susep) prohibited reinsurers from sharing risks in Brazil with other companies abroad, though it then amended its decision to allow sharing of 20% of the risk.

Such government intervention discourages competition. Today, insurance companies are mandated to transfer 40% of their risks to the main local reinsurer—still the privileged IRB—but can share only 20% of their risk abroad. "[When] reinsurance becomes more expensive for smaller and foreign companies, it smacks of protectionism," says Luis Augusto Carneiro, professor of economics, business, and accounting at the University of São Paulo.

CNSeg president Hilário agrees that the 40% to the IRB must be reviewed but is not sure how much government-created insecurity has actually affected businesses. For international insurance companies there is a high "Brazil cost," he admits: "a distribution system that requires use of local brokers, the high IOF tax, rigid limits on diversification of investments [only 2% can be in equities]. But nevertheless they continue to come." What concerns him more is a familiar threat: inflation, "which corrodes the currency, and makes it difficult to assess the value at risk."

The government has to establish clear and stable rules to foster a sound market—something that has not happened in the reinsurance market.

[2] Reinsurance is insurance that an insurance company buys from another insurance company (reinsurer) to lay off some of the risk.



# The risk of natural disasters

**Kalinka Iaquinta**, Rio de Janeiro

Unusually heavy rains followed by flooding and landslides, and at the other extreme severe droughts leading to loss of crops and livestock, indicate that the effects of climate change have not bypassed Brazil.

According to global reinsurer Swiss Re, in the last decade river floods and subsequent landslides accounted on average for annual losses of US$250 million in Brazil. Today, 9.4% of the population, mainly in the southeast, is exposed to river flooding and 6.9% to the risk of flash floods. And the frequency and severity of floods and droughts are expected to increase.

"In roads managed by the private sector, the rains early this year are causing financial losses more pronounced than the historical average," says Rodrigo Belloube, a department head with German insurer Munich Re. Similarly exposed were telecommunications and agriculture. He believes that "risks previously considered attractive due to the large pooling may deserve a review."

Rolf Steiner, Swiss Re regional CEO in São Paulo state, says that Brazilian people and companies do not have enough insurance against natural disasters. In the mountainous region of Rio de Janeiro state that suffered floods and landslides earlier this year, he says, "insurance penetration was less than 20%." The heavy rains there caused more than 900 deaths. In Nova Friburgo city, a textile center, many companies were badly damaged. "We lost 70 tons of products, worth around R$2.5 million," says Carlos José Hieke, general manager of the Hak Aviamentos company. That is not even counting lost earnings of R$4 million in the 10 days the company was closed.

Roberto Santos, vice president of the Union of Insurers of Rio de Janeiro and Espirito Santo, says that no insurance company lost much because "less than 15% [of those affected] had insurance against floods, flash floods, and landslides." Cars are the only property where insurance coverage is high, at 95%. For Brazilians car insurance is an expense that comes with purchase of a car; they do not think in those terms about homes and businesses.

## A rural problem as well

Natural disasters are also affecting Brazilian agriculture, where "we do not have the [insurance] culture of Canada, the United States, or European countries," says José Alcindo de Souza Avila, direc-

tor of the Federation of Agriculture of Rio Grande do Sul state, adding that 95% of crops are not insured. "People need to understand that insurance is the kind of thing we buy planning on not using it. Someone taking out a life insurance policy, for instance, does not think of dying."

But Avila also says that large insurers are not very interested in the agricultural market, "especially in Rio Grande do Sul state, where we plant wheat, soybeans, and rice and have many and severe periods of drought and rain." Ideally, he says, insurance offered to producers should take into account three points: producer resources, funding, and expected income, adding that "banks that finance farming should also finance crop insurance."

## Environmental risks: High premiums

Like the financial market, Belloube says, "Insurance and reinsurance normally operate in cycles, with periods when there is an upward movement in premiums and more restrictions on coverage, followed by periods when there is a general fall in premiums." The cycle depends heavily, he says, on "the rising cost of capital for insurers, which is reflected in premiums, particularly those with more complex risks — infrastructure or offshore operations, for example."

Belloube believes that in Brazil, increases in premiums will be more gradual, but "given the internationalization of the Brazilian market, it is unthinkable to imagine that we will not be affected."

Some insurance companies are already working to better price risks and to use new technologies to protect clients and themselves. They are considering, for example, agreements with weather forecasters. "The idea is, with at least a few hours advance notice, to… send text messages via mobile phone to insureds in that region, warning about the possibility of, say, flash floods," Santos explains.

Belloube adds that there is interest in controlling risk portfolios by region and in models that simulate catastrophic scenarios so that insurers and reinsurers can better scale their exposures to risk and price accordingly.



Photo: Wilson Dias /ABr



# Deep sea oil risks

**Thais Thimoteo**, Rio de Janeiro

After Deepwater Horizon spilled millions of gallons of oil into the Gulf of Mexico in April 2010, the cost of liability insurance for well operations shot up 30% to 50%. Just over a year later, equipment operators and Petrobras, Brazil's state oil company, are seeing insurance premiums higher by 10% to 15% for coverage of goods, equipment, and liability risks related to prospecting, drilling, and production of oil and gas.

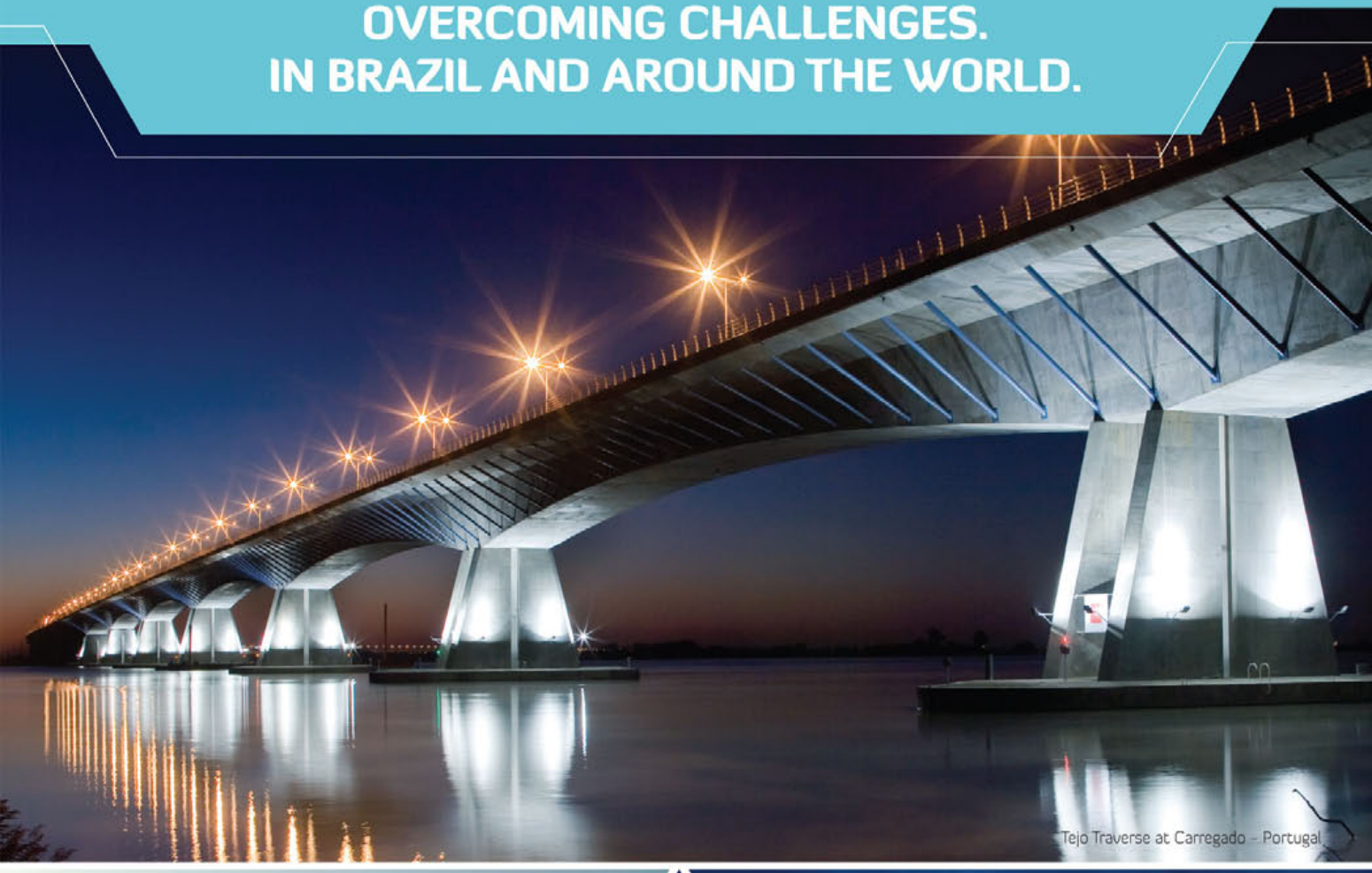
Petrobras has stated that "the increase in premium was concentrated in specific areas, such as control well operations and offshore liability [damage to third parties, including environmental impacts]." Hardest hit by the price rises, says Christian Negreiros Mendonça, risk manager of the Division of Oil and Gas of Schahin Engenharia, a Brazilian operator of drill ships and oil-ring platforms, were companies that had to renew their insurance after the Deepwater Horizon accident. This was not true for Schahin Engenharia, which is only now renewing its policies. In negotiating terms the company has achieved a 5% reduction in premiums over the previous policy, which is exceptional in the current market. "It is extremely important to close long-term contracts so as not to be caught by unforeseen events. The increase in our production scale has also given us more bargaining power," Mendonça says.

To some experts, what happened in the Gulf of Mexico need not imply problems for Brazil. Samuel Sitnoveter, CEO of broker Lasry Brasil Insurance, points out that in Brazil, "the deep sea oil is a relatively small share of the whole energy sector covered by insurance," which he estimated at about US$20–US$25 billion in annual premiums. Deep sea oil accounts for only about 5% of that. Although Sitnoveter recognizes the possibility of higher prices if there should be a large number of environmental accidents in a short time, "generally speaking, there is nothing to indicate that insurance premiums will rise in the oil sector."

In Brazil "generally two or three insurance companies assume the risks of a company. In the United States, an oil company's claims can affect 20 to 30 insurers. That affects the capitalization of all insurers simultaneously. With many claims insurers … are forced to boost their capital," says Newton Queiroz, director of Oil and Gas at AON Risk Services. He sees reason for optimism: "The interest of insurers in Brazil is enormous; and the more capital comes in the lower the cost of insurance." Queiroz says Petrobras, the main operator, has a good track record for operations, and strict regulation by the National Petroleum Agency and the Brazilian Institute of Environment and Natural Resources enforces safety and hence improves transactions with insurers.

Photo: Agência Petrobras

# OVERCOMING CHALLENGES.
# IN BRAZIL AND AROUND THE WORLD.



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# CHINA

## Changes in development model?

**China has unveiled an ambitious five-year plan. How likely is it to succeed? What might derail it?**

**Angélica Wiederhecker**, Beijing, China

When Jeff Immelt, chairman of General Electric, the world's largest manufacturing company, rose to speak at a dinner in Rome last year, he captured the growing disillusionment of some companies about China. Previously, corporate America had been a staunch defender of closer ties with Beijing but, Mr. Immelt told his audience, "I am not sure that they want any of us to succeed."

India, too, has had tense commercial disputes with China recently, even banning (temporarily) Chinese producers of telecoms equipment from operating in India. And where once only Washington made an issue of the Chinese currency, other countries have begun to express concerns that the yuan is significantly undervalued. Dilma Rousseff has signaled that the Chinese exchange rate has risen on Brazil's economic agenda. As the global economy still limps along, there is omnipresent potential for battles between China and many of its economic partners over exchange rates and other economic policies.



Photo: Roberto Stuckert Filho/PR

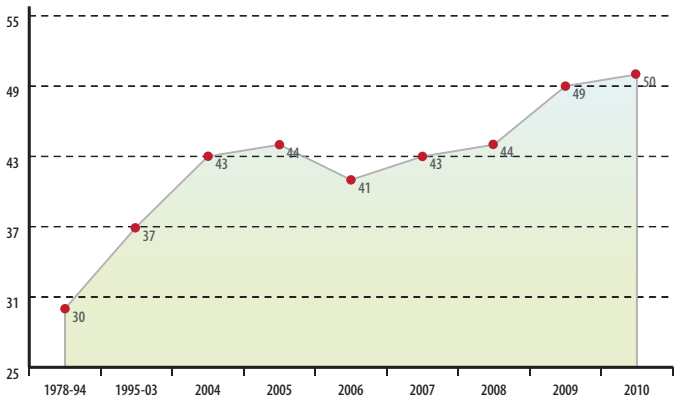
Chinese President Hu Jintao meets President Dilma Rousseff.

## The good news

Beijing is aware of the dangers. Its leaders have talked for several years about the need to alter the country's growth model to reduce reliance on exports and boost domestic consumption, which will also stimulate demand globally. In its new five-year plan, for 2012–2016, Beijing has detailed a road-map to restructure the economy that will, Chinese leaders

While the global economy still limps along, the potential for battles between China and many of its main economic partners over exchange rates and other economic policies is omnipresent.

**CHINA: INVESTMENTS (% OF GDP)**




Sources: World Bank and Pivot Capital.

In recent years, it has become clear that China was relying too much on a growth in exports that could not be continued without political backlash.

hope, create more sustainable growth and deliver more of the fruits of that growth to ordinary people. Their goal is to profoundly rebalance the Chinese economy not only in relation to the rest of the world but also internally, between manufacturing and services and urban and rural areas. If they are successful it will go a long way to relieve international economic tensions, regardless of what happens to the exchange rate.

## The bad news

The plan will be extremely hard to implement. China's leaders have been working for years on similar proposals, with limited results. To engineer a significant shift in the pattern of growth, the top leaders in Beijing will need to rein in deeply vested interests, from provincial governments to state-owned companies.

"The document sends a direct and unambiguous message to provincial governments that they should shift from a focus purely on growth to broader economic and social considerations," says Eswar Prasad, a former IMF official now at Cornell University in the US. "But it is not clear that incentives facing provincial governments can be shifted easily."

## The context

To make the case that China needs a new growth model might seem surprising given the country's recent success. The economy has grown at double-digit rates for over 30 years, even at a time when the global financial crisis had pushed most OECD economies into a deep slump. But in recent years it has become clear that China has been relying too much on a growth in exports that could not be continued without political backlash. It also depends too heavily on investment rates, which are becoming dangerously high. During its capital-intensive high-growth period in the 1960s

and 1970s, Japan was investing about 40% of GDP; in China in recent years investment has been closer to 50%. China's growth model, Premier Wen Jiabao himself has said several times, is "unbalanced, uncoordinated and unsustainable."

China has put boosting consumption at the center of the 2012–2016 plan. The growth target has been lowered to 7% a year, a stentorian statement that the authorities want to slow the pace of expansion. The plan also calls for household incomes to expand more quickly than growth. "We must make improving the peoples' lives a pivot that links reform, development, and stability," Wen Jiabao told this year's National People's Congress, where the new plan was first aired.

The plan calls for expansion of the services sector from the current 43% of GDP to 50% by 2015. Officials say they also want to raise basic prices of land, energy, labor, and capital, whose low cost is the reason for high investment. A main idea is accelerated urbanization: by integrating ever-larger numbers of rural migrants into city life, planners hope to boost consumption while making sure the real estate and infrastructure sectors do not collapse.

## The chances for success?

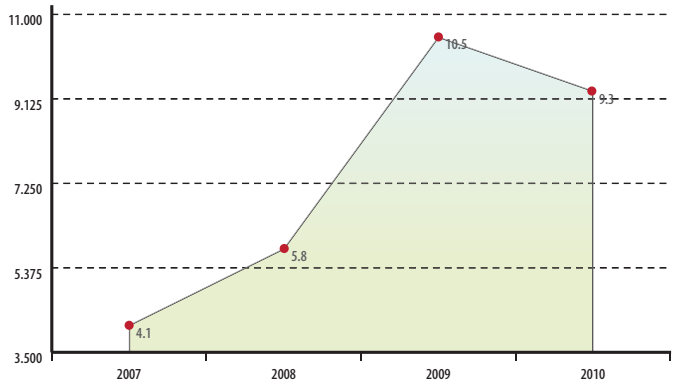
Despite the detail of the 5-year plan and the size of the planning bureaucracy that produced it, China is no longer a planned economy. In areas like energy, different arms of the state do control investment, so the targets for nuclear power and energy efficiency may be realizable. But economic planners do not have the tools to simply switch on more consumer demand and stop relying on public investment. That will require a much more complicated set of policies—one that will challenge some of the Chinese Communist Party's biggest vested interests.

A major battleground will be the financial system. Chinese households have $4 trillion in bank deposits, which currently earn negative real returns and at the best of times have enjoyed only very modest returns. The effect has been to repress household spending while providing an enormous incentive for investment-heavy economic growth. A real interest rate just 1 or 2 percentage points higher than its long-run average would be a highly effective way to increase the incomes of hundreds of millions of Chinese families.

Unfortunately, for the past two years Chinese state-owned companies and local governments have been on a borrowing spree to finance post-crisis stimulus spending, which came largely in the form of bank credit rather than fiscal spending. New bank loans doubled in 2009 and almost did so again in 2010. Considerably higher interest rates would put enormous pressure on

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**CHINA: NEW BANKING LOANS (Yuan trillions)**




Source: Fitch.

Even though state-owned companies recorded substantial headline profits between 2001 and 2008, they would have operated at a loss if it had not been for subsidized credit and low-cost land.

many lenders and could provoke a financial crisis for many local governments. As for state-owned companies, a recent study by the Unirule Institute of Economics, a Chinese think tank, found that even though they recorded substantial headline profits between 2001 and 2008 they would have operated at a loss but for subsidized credit and low-cost land. While annual financing costs for private companies were 5.5%, state-owned companies paid only 1.6%. Arthur Kroeber, head of the Dragonomics consultancy in Beijing, says, "If the authorities cannot create a system that allocates capital more efficiently, it will be difficult to maintain high rates of growth."

The Chinese central bank has been pushing for years for more liberal interest rates on savings accounts, which are currently set by the authorities, so that depositors can get higher returns. It has been forcefully opposed by the large state-owned banks, which would lose the 3 percentage point spread they currently enjoy between deposit and lending rates—and possibly lose their profitability.

Today many Chinese politicians might be even more reluctant to reform a banking system that seems to have served them well during the crisis. The government's ability to instruct banks to ramp up lending as the crisis hit made it possible for China to ride out the storm. Reformers argue that direct government control of financing is not suitable in less turbulent times and that gradual liberalization would improve the efficiency of bank lending, but the crisis has made such arguments a much harder sell in Beijing.

The same vested interests have spoken out loudly in the debate over corporate dividends. Until recently state-owned companies did not actually pay dividends even though some of them

– such as the Industrial and Commercial Bank of China, China Mobile, and PetroChina – are among the largest companies in the world. Reformers have long argued that these companies should pay dividends so that, among other reasons, the funds could be channeled into increased social spending. "If state-owned companies do not pay dividends, it is essentially creating unfair competition for private companies. They can pay higher salaries and reinforce their dominant position in the market," says Tang Min, secretary-general of the China Development Research Foundation in Beijing. After a long political battle, state-owned groups finally began to pay dividends two years ago and the rate has risen this year. However, most of the money goes to the government body that manages state-owned assets for investment in other such groups rather than to social spending. Thus the dividends do not actually leave the state's coffers.

## Where to find efficiency?

Although boosting services is a central part of the blueprint for changing the pattern of growth, most service industries are dominated by powerful state-owned companies. However, logistics is one area with huge potential efficiency improvements. At present, the logistics system in China is dominated by regional monopolies. By gradually breaking up those monopolies, the cost of moving goods by road could drop sharply, which would also open the way for big investments in new logistics operations. Government officials also see considerable potential for expansion in tourism.

But the telecoms industry is controlled by three huge companies that will fight fiercely against any threats to their domination. Financial services are also dominated by bloated state-owned firms with enormous political influence. China has a large informal banking sector, which is especially active in the east coast provinces. Reformers have lobbied for over a decade that such underground banks be legalized – a vital step toward expanding access to cheaper and more reliable bank credit. All such moves so far have been blocked. Media is another sector where growth could be rapid if restrictions were lifted. There is huge untapped demand for new television programs, magazines, and films. But tight control of the media is key to the Communist Party's monopoly on political power.

## Promoting internal migration

Perhaps the most politically sensitive part of the 5-year plan is a commitment to reform the hukou, the household registration system that divides rural and urban residents. One of the defining features of modern China, because of the hukou tens of

Perhaps the most politically sensitive part of the 5-year plan is the commitment to reform the hukou, the household registration system that divides rural and urban residents.

The most powerful reason for skepticism about the plan is that all its priorities —boosting household income and consumption, reducing inequality, rebalancing the economy away from exports — were central themes of the previous 5-year plan, yet for most of them, performance was actually worse.

millions of migrant workers who have moved from villages to work in factories or construction sites are not treated as permanent city residents and have no access to urban schools and other social benefits. Because these migrants have little stake in the cities where they live, they save their salaries to send home. Phasing out the system as planned would transform these workers into permanent residents who buy houses and bring their families to the city. It would provide a great impetus behind the urbanization drive at the heart of the 5-year plan.

But reform of the hukou system requires a huge reform in core political arrangements related to local governments and land. The reason migrant workers are not entitled to many services is that local governments cannot afford to provide them. Local governments in China must rely on direct funding from the government in Beijing and revenues from one-off sales of land to property developers. Although Shanghai and Chongqing, a city in central China, have begun to tax property modestly for the first time, Beijing has backed off plans to introduce bigger property taxes across the country for fear that would depress the housing market. Creating a sustainable source for financing local governments will be one of the thorniest political issues over the next decade.

To reform the hukou system, Beijing also needs to look at the other end of the process, the land that migrant workers hold in their home villages. Under China's complicated land system, individuals can have legal title to property in cities but not in the country. Families in rural areas, almost all of which have a small holding as a result of land reforms in the 1950s, can lease the land to other farmers but not sell it or use it as collateral. This is another obstacle to permanent urbanization.

State ownership of farm land is another hugely sensitive political issue that goes to the heart of Communist Party orthodoxy. At a party congress in 2008 Hu Jintao appeared to have won support for a proposal to allow farmers to sell their land, but he was inexplicably forced to backtrack. "If we are to end the apartheid that is the hukou system and create better-quality urbanization,

# The BRICS: Uneasy partnership

Because the BRICS group of developing economies has been accused of lacking a purpose, the Chinese hosts of this year's meeting tried to inject some geopolitical substance into the proceedings. (The group, then consisting of Brazil, Russia, India and China, was named by a Goldman Sachs economist. It has now added South Africa.)

Beijing had seemed somewhat aloof from the previous two annual BRIC summits. Yet before the April summit in Hainan island, off the south coast of China, Beijing officials worked hard to boost its status. Some even talked of establishing a permanent BRICS secretariat, the first stage in institutionalizing the grouping.

"In the past, the emerging powers acted individually and were often unable to effectively meet the challenges from the West. Now they can coordinate their policies and movements more efficiently," said Yang Jiemian, head of the Shanghai Institutes for International Studies and a leading supporter of a more foreceful BRICS platform. At China's behest, the summit criticized the military campaign in Libya—an attempt to clip the wings of the UK, France, and the US.

Beijing sees the other BRICS countries as useful allies to deflect pressure from western nations, as became clear during the Copenhagen climate change summit. With the US seeking allies for its campaign to lobby China to strengthen its currency, Beijing is even keener to create a closer bond with the other BRICS countries.

Brazil also used the summit to score geopolitical points, lobbying for a statement in favor of expanding the United Nations Security Council. The summit was also a chance for the other countries to press Beijing on bilateral economic issues. India pushed for greater access to the Chinese market for its pharmaceuticals and IT companies. Brazil warned Beijing about mounting complaints from trade unions and industrial groups that have led Brasilia to introduce a large number of anti-dumping measures this year against Chinese goods.

Brazilian officials also lobbied on behalf of Embraer, the aircraft manufacturer whose request to build its E-190 jet at its joint venture plant in China was recently rejected by Beijing. The Chinese argued that the E-190 would compete with their own plans to build regional jets. For China, the call for a stronger BRICS voice only goes so far.

we need a package of policies that addresses both local government finances and land reform," says Tao Ran, a land issues expert at Renmin University in Beijing. "But there has been little progress during the Hu-Wen administration."

## Speed zone ahead

The next 5-year plan will be introduced just as a new generation of leaders takes office. The general assumption is that during 2012 and 2013 Xi Jinping will replace Hu Jintao as head of the Communist Party and president of the country and Li Keqiang will succeed Wen Jiabao as premier, in charge of day-to-day government business. Lacking any formal power base, the new leaders will need first to build up their own support within the party and the bureau-

cracy, which could make them overly cautious for the first few years. Caution is not inevitable; Hu and Wen were able to use the SARS outbreak in 2003, just before they took office, to stamp their authority on the party apparatus. But at the start it will not be easy for the new leaders to make politically difficult decisions.

The most powerful reason for skepticism about the plan, however, is that all its priorities —boosting household income and consumption, reducing inequality, rebalancing the economy away from exports — were central themes of the previous 5-year plan, yet on most of them, performance has actually been worse. And while the central government targets annual growth of 7%, the plans of Chinese provinces forecast a collective growth rate of 11%. Local governments, it seems, are betting that the public investment spree will continue. "Maybe the government this time round will force through the necessary rebalancing," says Paul Cavey, economist with Macquarie Research in Beijing. "But the experience of the last few years suggests we cannot be sure these aims will be fulfilled."



Photo: Antônio Milena/ABr

Beijing.

# Latin America matures as a region

**Anne Grant**, Washington D.C.

At "Opportunities in a Changing Americas," sponsored by the Council of the Americas, high-ranking officials from throughout the hemisphere applauded how much has been accomplished from Canada to Tierra del Fuego—but also identified plenty of areas where continued work is needed. Brazil's growing "economic and political clout" (in the words of Ambassador John Negroponte, chairman of the Council) got considerable attention, but the general tone is clear in the celebratory but honest speech given by U.S. Secretary of State Hillary Rodham Clinton (see excerpts), who also urged "Let's quit doing what doesn't work and let's start doing more of what does."

In speaking to "Regional Diplomacy: The U.S. View," U.S. Assistant Secretary of State for Western Hemisphere Affairs Arthur Valenzuela spoke of efforts to reframe relationships: "The old narrative [which accentuated Cold War priorities] still has powerful sway," but there has been unprecedented social, economic, and political success "resting on community and democratic development" that has been built on sound policy and protection of rights. He sees robust and pragmatic partnerships, global as well as hemispheric. He also commented that across the hemisphere "ordinary citizens and visionary leaders … have united to bring the region to maturity."

## Brazil's deep sea oil

U.S. Secretary of the Interior Ken Salazar spoke of his "authentic and sincere belief" that Latin American countries working together can bring prosperity and general growth. He also gave considerable attention to the problems Brazil faces in extracting deep sea oil. Some of the problems may be political; the U.S. and Mexico, for instance, are working on a protocol for single standards for oil exploration and development in the Gulf. But many are technological. Secretary Salazar noted that there were important lessons to be drawn from the Deepwater Horizons blow-out in the Gulf. But he noted that the ocean floor in the Gulf is a mile below the surface; Brazil's deep sea oil reserves are four miles down. He and his staff were recently in Brazil and met with the Interior Ministry and Petrobras; both countries are working to share the best of technologies.

In his remarks El Salvador President Mauricio Funes emphasized multilateralism and globalization, and how since 2009

Photo: Fabio Rodrigues Pozzebom/ABr



Hillary Clinton, U.S. Secretary of State

Photo: Roosewelt Pinheiro/ABr



Felipe Calderón, President of Mexico

his country has worked to strengthen democratic institutions while dealing, unlike Brazil, with a severe economic contraction of 3.8%. In a dramatic reversal, 2010 growth is estimated at 2.5%. Funes pointed to such positive indicators as growth in remittances and recovery in the manufacturing and agricultural sectors. Also, the fiscal deficit has decreased from 5.6% to 4.2% of GDP.

Canadian Finance Minister James M. Flaherty made it clear that (like Brazil) "we need trade to prosper." (Unlike Brazil, of course, Canada has a Pacific as well as an Atlantic coastline.) In the absence of agreement in the Doha round, to stimulate trade Canada is working on a number of free trade agreements (FTAs), primarily in the Americas but also with India.

## Ethanol subsidies

In a discussion between Council Chairman Negroponte and U.S. Senator John McCain, Negroponte said that although Brazil has signed agreements with U.S., the details must still be ironed out, adding that "the problem is the ethanol tariff" on imports from Brazil. McCain responded, "There has been no greater hoax than ethanol subsidies [to U.S. producers]; they're a testament to the power of special interests." The next biggest hoax, he added, is U.S. subsidies to sugar producers. McCain went on to say that he understands Brazil's frustration; for decades he had been hearing that Brazil was a sleeping giant, and "now the sleeping giant has awakened."

Colombian Minister of Finance Juan Carlos Echeverry spoke on "Colombia's Path to Growth," sounding themes that many commentators on Brazil will find familiar. Colombia is very much in favor of free markets. It is also moving to better income distribution; here Echeverry pointed out similarities between Colombia and Brazil. Both, he said, have "a ring of poverty around a core of wealth." Colombia is making more social investments, in education, research and development, and health care, and is also investing heavily in infrastructure, from ports and roads to broadband. The country is taking a strong stand against corruption and is determined to improve the business climate, in part because as the middle class grows, so does demand. Colombia is even considering constitutional reform to "give

## Excerpts from Hillary Rodham Clinton's Speech

Despite whatever is going on elsewhere in the world, there is nothing more important [to the United States] than continuing our work [in the hemisphere] to consolidate democracy, embrace smart economic policy, continue lifting tens of millions of people out of poverty, taking on a more active role in the world, and generally making it clear that we are in this together. For our own economic interests … we have no more important partners than those in this hemisphere.

There is power in our proximity—our geographic proximity to be sure, but also the proximity of our economic interests, our values, our culture, and the challenges we share.

We've had a flurry of activity lately, highlighted by President Obama's trip in March. In Brazil, he completed agreements for high-level dialogues on economics and energy, which we believe will promote cooperation, streamline regulations, and help us take concrete steps that provide tangible benefits to all of our people.

Early this year we intend to send Congress legislation that would implement three pending free trade agreements (FTAs). In addition, we will be sending our broader trade agenda, including renewal of Andean trade preferences …. In the United States alone, the Colombia [and] Panama [FTAs] and Andean trade preference renewal could add more than $10 billion to our economic output, and that would translate into some 70,000 new jobs for American workers. And in the weeks since President Obama's visit to Brazil, the array of agreements he announced—on infrastructure for the World Cup and the Olympics, on aviation and maritime transport, on biofuels, R&D, and so much more—is spurring a serious acceleration in our economic relationship.

All of these opportunities are going to require leadership. We still face a huge inequality gap in Latin America. In fact, from the United States south we do, because … unfortunately, our country has one of the largest gaps in inequality. So we've got to continue to focus on how we help equip people with the skills and tools they need to make the most of their God-given potential.

But let's be honest: there are still weak education systems, there are still weak democratic institutions, there are still inadequate fiscal policies, there are still too few people of means paying their fair share of taxes to their government to support services for those who will otherwise be mired in generational poverty, and there is too much violence. If we don't face up to these challenges, we could waste this historic opportunity.

the fiscal rules teeth" and ensure fiscal stability and sustainability; the Minister pointed out that today only Germany has such provisions.

Finally, Mexican President Felipe Calderón brought the conference up to date on what is happening in his country: Last year, Mexico had 5.5% GDP growth, added 150,000 jobs, invested 5% of GDP in infrastructure, and graduated 90,000 engineers and technicians—more than Canada and Brazil, he pointed out. Since Calderon took office, tariffs have been reduced to 5% and Mexico has risen in the World Bank Doing Business indicators from 73rd to 35th. Also, it now has, he said, the lowest cost for manufacturing in the world—even lower than China. He also identified three areas of bilateral partnership with the United States: immigration, security, and climate change.



# The new geography of Brazil's world trade

**Lia Valls Pereira**

China has been central to much of the current debate on Brazilian foreign trade. It is the main destination of Brazil's exports, but these are concentrated in a few commodities (in 2010 63% were iron ore and soybeans). China's share of Brazil's exports (15%) is the same as the U.S. share, yet Chinese competition is seen as a threat to the survival of some industries in Brazil. Moreover, China crowds out Brazil's manufactures in other markets: It started with Chinese shoes conquering the U.S. market, and now Chinese machinery competes in South America, where traditionally Brazil's machinery had a comparative advantage.

Because the issues are extremely important, debate about what responses are possible is intense. Chinese direct investment in sectors that add value to basic products could promote export competitiveness. Trade protection measures (anti-dumping), transitional safeguard provisions, and perhaps taking the exchange rate issue to the World Trade Organization (WTO) could

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*China accounted for 24% of the total trade between Brazil and Asia in 2002 and 50% in 2010.*

reduce Chinese imports. Yet China will continue to have an important role on the agenda of foreign trade not just for Brazil, but for the entire world.

A question arises in the face of the changing geography of trade: Is Brazil still a global trader? In 2002 Brazil's foreign trade (exports plus imports) was US$108 billion. The participation of the European Union (EU) was 27%, the United States 24%, Latin America and the Caribbean 18%, and Asia 16%. In 2007, before the global crisis and the surge in commodity prices, Brazil's trade flow was US$281 billion with the EU accounting for 24%, Latin America and the Caribbean 22%, Asia 20%, the U.S. 16%, and other countries 18%.

## LEADERSHIP

Because the pace of recovery in developed countries is slower than in Latin American and Asian emerging countries (especially China) and because of higher commodity prices, in 2010 Asia took the lead in Brazil's trade (US$384 billion). Asia's share was 29%, Latin America 21%, the EU 21%, the U.S. 12%, and other countries 17%.

Growth in Asia is associated with China, which accounted for 24% of the total trade between Brazil and Asia in 2002 and 50% in 2010. As for the United States, it is important to note that its participation in Brazil's trade dropped before the global crisis or the appreciation of the Brazilian real. Moreover, the decline is more pronounced in exports — the U.S. share declined from 22% in 2002–2005 to 13% in 2006–2010 — than in imports — down from 19% to 15%.

The fall in exports to the EU was less, from 25% in 2002–2005 to 23% in 2006–2010, while the EU share of Brazil's imports fell from 26% to 22%. The high share of primary commodities (45% in 2007) in exports to the European market accounts for the relative stability in the percentage because prices of agricultural products and minerals are higher.

The Latin American share in Brazil's exports increased from 22% to 25% and imports held constant at 17%. Here, however, the China effect is present indirectly: Countries like Argentina, Chile, and Peru benefit from sales of commodities to China and gain purchasing power to import Brazilian manufactured goods.

Brazil thus remains a global trader, although the geographic configuration is less balanced than in 2002 and 2007.

## BALANCES

In 2007 Brazilian GDP grew 6.1% and trade volume 7.2% (trade as calculated by the Interna-

tional Monetary Fund). The Brazilian trade balance surplus reached US$40 billion. Brazil recorded surpluses with Latin America (US$20.4 billion), the U.S. (US$6.4 billion), and the EU (US$13.7 billion) and a deficit of US$5.6 billion with Asia, of which US$1.9 billion was with China.

Last year, Brazil's GDP grew 7.5% and trade volume by 12%. The trade balance reached US$20.3 billion. Brazil recorded surpluses with Latin America (US$17.2 billion), the EU (US$4 billion), the Middle East (US$5.8 billion), and Asia (US$ 130 million). The trade surplus with China was US$5.2 billion, but Brazil had a deficit with the rest of Asian countries of US$5.1 billion. China may be exporting to Brazil through its production networks in Asia.

Then, between 2007 and 2010, with higher economic growth of 1.4 percentage points, which favors imports, but with 4.8 points higher trade, which reflects an increase in external demand, Brazil's trade surplus declined by half. The exchange rate is the natural candidate for an explanation of this difference. Between 2007 and 2010, the effective exchange rate of the real appreciated by 26%. The good result for Latin America, where exports are concentrated in manufacturing, suggests that Brazilian businesspeople have managed to maintain their profit margins. There is no guarantee, however, that this will be the case if the exchange rate appreciates further.

Today any debate on Brazilian foreign trade leads to the themes of the exchange rate and whether China represents a threat or an opportunity. However, at all times we should keep in mind that Brazil is still a global trader.

In the short term, external vulnerability seems not to be an issue since capital inflows ensure financing of the external current account deficit and the outlook is for a trade surplus of US$16 to US$18 billion — conditional, of course, on commodity prices, China's demand, and a stable exchange rate.

The search for new opportunities, improvement in infrastructure, and reduction in administrative costs and the tax burden must remain priorities for the foreign trade policy agenda. Between 2005 and 2008, Brazil exported only 31 new products, so diversification of exports is also a challenge; specialization in commodities may be enough to serve the Chinese market, but it is not enough to ensure the dynamism of a global trader.

*The search for new opportunities, improvement in infrastructure, and reductions in administrative costs and the tax burden must remain priorities for the foreign trade policy agenda.*

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