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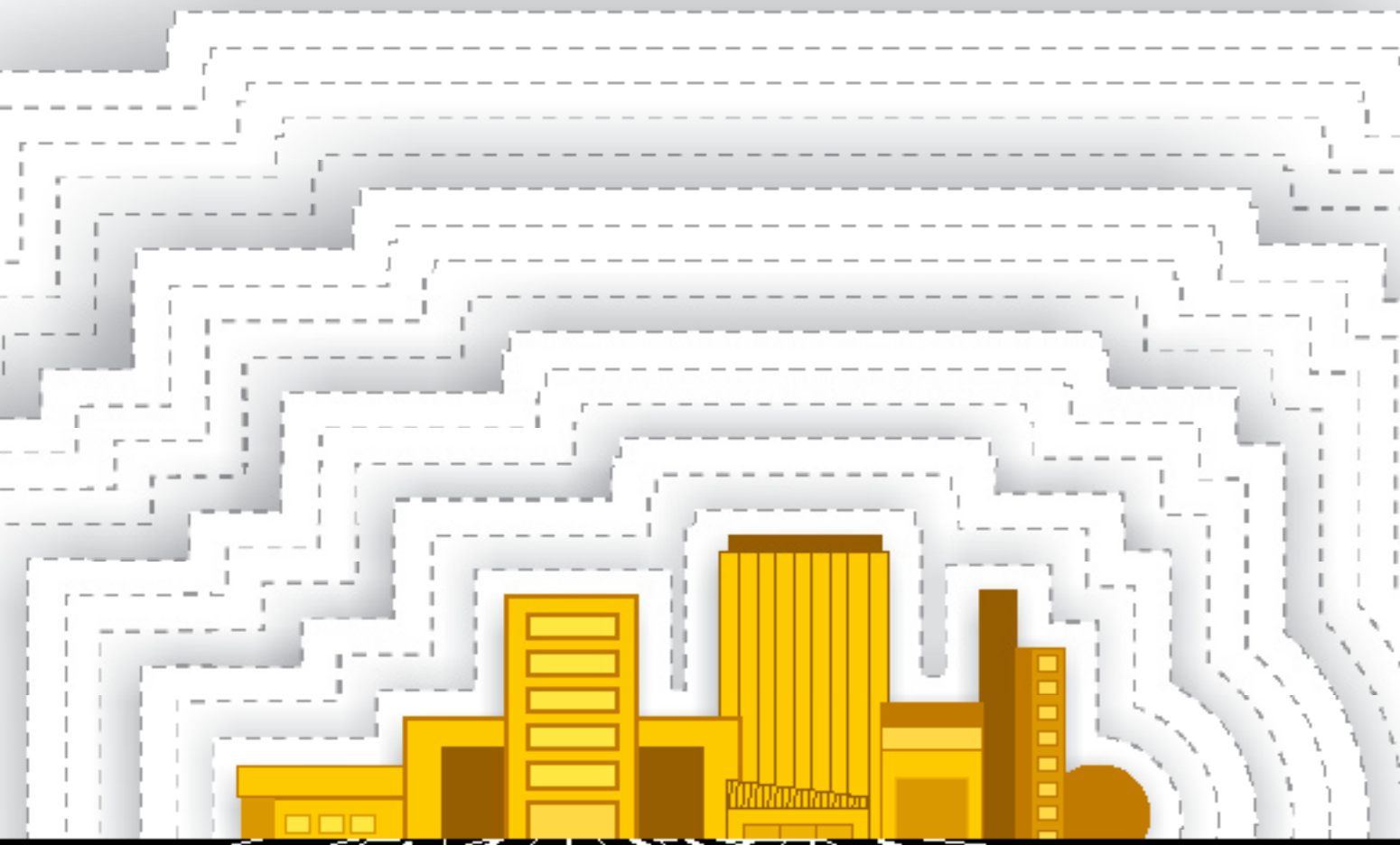
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Brazilian Ambassador to the US

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It has been 40 years since Brazilian industry has experienced such a favorable situation for investment as it does today. Yet how will Brazilian industry contribute to the country's growth? Inadequate infrastructure, high taxes, deficient public services, scarce and expensive credit, and an unclear industrial policy that for many analysts is not tailored for Brazil's sustainable growth and greater integration into the global markets — with such negative factors for industry, the future is uncertain.

As industry's share in gross domestic product (GDP) has declined in recent years, a major structural change has occurred in Brazil's exports: manufactured goods have been losing ground to commodities, a phenomenon similar to what is happening in other emerging economies.

This trend began in 2007 and has accelerated since the recent global financial crisis. China's inroads into traditional markets for Brazilian products explains in part the gradual decrease in the share of manufactures in our trade balance. According to Miguel Jorge, Minister of Development, Industry and Foreign Trade, Brazilian exports with higher added value are likely to continue losing ground because other countries have more aggressive policies, and the economies of the United States and Europe are recovering very slowly.

Investing in technological innovation, clearly defining industrial policy, and making the structural reforms necessary to reduce the tax burden on industry may be some ways that can advance a greater role for industry in Brazil's economic growth and a better position in world trade in coming years. These are some of the issues we look into in the cover story for this issue.

Brazilian deindustrialization: A compelling debate

One of the most intriguing economic debates in Brazil today refers to whether or not there is a program for reducing the participation of industry in the economy — deindustrialization. The theory is that deindustrialization began with the appreciation of the exchange rate after the Real Plan was adopted in 1994 and has been exacerbated by economic crises since 2002. Brazilian industry, it is thought, is also threatened by the advance of China's share in global manufacturing, driven by low wages and the policy of keeping the yuan undervalued.

This discussion is not simple. Even those that see deindustrialization admit that there is no obvious process underway, only some historical evidence over the longer term. Also, Brazil's industrial production has been satisfactory considering the fluctuations of GDP. Others see no real threats to the industrial sector.

There is no doubt that compared to other sectors industry has been shrinking since the mid-1980s.

History — There is no doubt that compared to other sectors industry has been shrinking since the mid-1980s. The share of manufacturing in Brazil's GDP rose from 20% in 1947 to a peak of 36% in 1985 but by 2008 had declined to 16%. A more detailed examination of this trajectory shows that large declines in the share of industrial products in GDP, as in 1990 and 1995, correspond to changes in how GDP is calculated. Correcting for changes in methodology, these declines were smaller than previously thought. Between 1994 and 2002 the industrial share in total production declined due to the instability the Brazilian economy was experiencing. As industrial production tends to slow down more than GDP in recessions — and grow more in recoveries — periods characterized by economic crises reduce the weight of industry in aggregate economic activity. The opening of trade from 1990 to 1992 during a domestic recession seems also to have had a significant suppressive impact.

But an analysis of employment in manufacturing as a share of the employed population supports a different perspective. Industrial employment rose from 12.8% of the total in 1992 (a recession year) to 14.4% in 2008, according to the National Household Survey. This is confirmed by the results of the Annual Industrial Survey of the Brazilian Institute of Geography and Statistics: industrial employment reported by companies increased from 7.4% of total employed population in 1996 to 8.4% in 2008.

International experience — Looking at a group of 185 countries for 1970–2007 reveals a worldwide decline of industrial production in relative terms from 25% of world GDP in 1970 to just under 17% in 2007. Comparing 16 countries similar to Brazil, Brazilian industrial production was 4.9 percentage points of GDP higher than the group average for 1970–1972. Since then, as with the rest of the world, almost

all these 16 economies have experienced a relative reduction in the share of industry in GDP: for the whole group, the share of industry in GDP decreased 5.8 percentage points, although Brazil's fell 9.6 percentage points — bringing it closer to its peers.

Based on data from 185 countries, and given the relationship between per capita income and industry, Bonelli and Pessoa (2010) indicate that in an economy like Brazil the industry's share of GDP should have been substantially below what in fact existed between 1970 and 1975. For 2001–2007, the share of Brazilian industry was slightly above what they would have expected.[1]

So this study seems to see no evidence of deindustrialization in Brazil, at least in relative terms. For 1970–1980, perhaps because the policy of import substitution deepened, Brazil was "over-industrialized" compared with what would be expected from a country with our socioeconomic characteristics, technology, and allocation of production factors at the time. Since the 1990s, Brazilian industry's share in total production has returned to a level considered normal by international standards.

Current situation — According to projections from several economic analysts, Brazil is entering a phase of external current account deficits that should last several years. In the first half of 2010 the deficit reached 2.47% of GDP, roughly double the deficit for the first half of 2009.

High external deficits and exchange rate appreciation supported by international capital inflows obviously raises concerns about the impact of a strong currency on the industrial sector. So, although there was no evidence of deindustrialization in Brazil in 2008, has the appreciation of the currency over the past two years, together with China's expansion of manufacturing exports, affected industrial external competitiveness and precipitated deindustrialization in Brazil?

After the atypical year of 2009, what is worrying is that Brazilian manufactured goods exports have not returned, like most other economic indicators to 2008 pre-crisis levels. As the effects of the global turbulence were dissipating fast among emerging countries, the currencies of these countries — especially those, like Brazil, that benefit from high volumes of commodities exports — appreciated against the dollar, and therefore against the yuan as China kept its nominal exchange rate stable against the dollar. Furthermore, with the retraction of consumption in rich countries, whose economies were more deeply damaged by the crisis, China has redirected its exports to emerging countries. In Latin America — a prime market for Brazilian manufacturing — Chinese manufactured products come into direct competition with Brazilian goods. Moreover, industrial goods exported from China also compete with domestic products in Brazil. These factors help explain the increase in Brazilian commodities exports and the decline in its manufacturing exports.

According to Bonelli and Pessoa's study, there seems no evidence of deindustrialization in Brazil, at least in relative terms.

Though it would be premature to declare that Brazil is suffering from deindustrialization, the issue does deserve further study. Empirical evidence until at least 2008 does not seem to corroborate any process of deindustrialization, but in recent times, and especially in the post-crisis period, there are signs that Brazilian manufactures have become less competitive. There is no reason for hasty reactions — especially regarding changing current economic and exchange rate policy. This would certainly be wrong. But the issue would benefit from rigorous examination.

[1] Regis Bonelli and Samuel Pessoa, "Desindustrialização no Brasil: Um Resumo da Evidência," Center for Economic Development, IBRE-FGV, May 2010, http://portalibre.fgv.br/main.jsp?lumPageId=8A7C8233253AEA0A01253B17F4990DE9&contentId=8A7C823328345192012888D82A0536E4.

Brazil and the United States: A convergent dialogue



Mauro Luiz Iecker Vieira

Brazilian Ambassador to the United States

Pinheiro Ronci, Washington D.C.

Before being appointed ambassador to the United States, Mauro Vieira had been Brazilian ambassador to Argentina since 2004. In the Ministry of Foreign Affairs Vieira has also served as Chief of Cabinet of the Secretary-General and Chief of Cabinet of the Minister. Vieira believes the US and other countries are now seeing Brazil as a privileged interlocutor for dealing with major global issues. The US is also more willing to dialogue with other countries on major international issues. Vieira notes that, despite some differences, the US and Brazil have convergent values because both are large multiracial democracies with large economies committed to the free market but tempered by the notion of social justice.

***The Brazilian Economy* — There seems to be authentic American interest in listening to Brazil's views. What has brought about this renewed dialogue?**

Ambassador Mauro Vieira — The US and Brazil have historically had a close and productive dialogue, especially about the regional agenda. The novelty in recent years is that the US, as well as other countries, has increasingly begun to see in Brazil a privileged interlocutor for dealing with major global issues. This is due, of course, to the image our country enjoys since it has stabilized the economy, resumed growth, and begun to address old social debts, all supported by full democracy. These processes together give consistency to national development and allow Brazil to assume international responsibilities commensurate with its capabilities.

The US is also more willing to dialogue with others, among them the emerging powers, about major items on the international agenda. This process began, though modestly, in the second term of President George W. Bush, perhaps as a way to repair the damage to the US image caused by the unilateral excesses of his first term. It has

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intensified in the Obama Administration, which has as a fundamental foreign policy assumption the fact that the US — exhausted by two wars and a deep financial crisis that undermined public finances — can no longer afford omnipotence. As a result, the US should allow adjustments to the international order so that new players like Brazil can assume greater responsibilities and thereby contribute to the full extent of their capabilities to solving today's challenges.

This greater American willingness does not imply a simple process, free of obstacles. Sometimes Brazil and US perceptions will converge and the dialogue will be easier, as on climate change. In other cases, we will have different perceptions, diagnoses, and solutions, as with Iran. What is true in each case, however, is that, to quote US Ambassador to Brazil Thomas Shannon, "The US needs to get used to the idea that, from now on, it will come across Brazil in places where it previously would not expect to find Brazil."

Thanks to its large and vibrant economy, market-oriented policies, and stable democracy, Brazil is seen as a respected interlocutor, skilled negotiator, and independent mediator, able to find shortcuts to collaborative solutions among countries of diverse political persuasion and social background. Some believe that it would be very beneficial for Brazil to be a permanent member of the UN Security Council, with or without a veto. What role could Brazil play internationally?

After almost a century and a half of peaceful coexistence with a dozen neighbors, Brazil has much to contribute in the international sphere. As a result of this experience, Brazil would bring a unique perspective to the Security Council, whether as an elected or, we hope, a permanent member. We believe that the defense of international law and the primacy of diplomacy and dialogue are the best way to resolve tensions.

Given the diversity of Brazilian interests, too, there is no multilateral forum where we should be missing. We have the ability to interact with South and North with the same ease, to build bridges and build consensus, to find new ways, all of which place us in a privileged position. Today, Brazil is vital to resolving knotty problems. There will be no successful conclusion of the Doha Round of the WTO without the G-20, where Brazil is among the leaders. We will have no progress in talks on climate change without the large emerging countries like Brazil. The multipolar world that so many talk about is being created, and we are an active part of the process.

Brazil and the United States have, perhaps for the first time, positions on Latin America that if not identical are at least converging. What are the areas of common interest?

Even when both countries have different perceptions, there are frequent discussions so that the positions of one do not take the other by surprise. What is important is that, beyond their differences, the US and Brazil have converging values because both are large multiracial democracies with large economies committed to the free market but tempered today by the notion of social justice.

This convergence opens immense ground for bilateral cooperation, and increasingly

The US is also more willing to dialogue with others, among them the emerging powers, about major items on the international agenda.

for trilateral cooperation — both countries cooperating on development projects for a third country with fewer resources. This is an increasingly important aspect of our relationship, particularly in Latin America and Africa. For example, we are cooperating to develop the biofuels industry; we began with the Dominican Republic, El Salvador, Haiti, and St. Kitts and Nevis, and later expanded to Guatemala, Jamaica, Guinea Bissau, and Senegal.

We have the ability to interact with South and North with the same ease, to build bridges and build consensus, to find new ways, all of which place us in a privileged position.

Today it is also well understood that Brazil and the US must closely coordinate their efforts to help Haiti recover. Some efforts Brazil will manage alone, such as construction of the Artibonite hydroelectric power plant, but Brazil and US can also work together to benefit the Haitian people, notably in promoting productive investments in the country by both granting tax benefits to their domestic companies to operate there.

According to Walter Russell Mead, Brazil could serve as a center of development and political stability in Latin America. How would you rate Brazil's performance in the building of regional institutions?

For Brazil, promoting Latin American integration is a mandate enshrined in Article 4 of the Constitution, which deals with the principles that guide our foreign relations. Integration is therefore a Brazilian government policy that began with Mercosur and has accelerated enormously in the present administration. The inclusion of Venezuela, given the potential of its economy, the importance of its oil and gas, and its projection into the Caribbean, guarantees Mercosur an entirely different strategic dimension.

But our efforts go well beyond Mercosur. We have made great strides in South American integration both economically — with important infrastructure works and especially with the increasing presence of Brazilian companies in neighboring countries — and institutionally. Today the UNASUR is an established venue that has forged a genuine culture of dialogue, allowing us to overcome serious regional challenges, such as the incident between Colombia and Ecuador. We have also launched a productive dialogue on defense with the South American Defense Council and on supranational challenges, such as drug trafficking, that can only be addressed properly by all countries at once

Also, in December 2008 all the heads of states in Latin America and the Caribbean met for the first time. The process created its own dynamic, which is great for the region. Because no one is excluded, it lays the groundwork for more harmonious dialogue between similar countries focused entirely on their common challenges. It does not attempt to supplant other initiatives of wider scope, such as the OAS.

The internationalization of Brazilian interests has caused Brazil to become concerned about stability and order in Latin America; in the past these were exclusive concerns of the US. What major threats face Latin America?

The historical challenge in Latin America, the source of almost all the other ills facing the region, is social inequality. The tensions caused by the disparity between rich and poor partly explain other phenomena, such as political unrest or crime.

Fortunately, the last few years have been marked by almost universal advances in combating inequality. That is the result of deepening democracy, as previously excluded masses begin to take an active part in the political process, demanding that the benefits of economic growth be distributed more equitably. This process naturally causes tensions, but to the extent that democratic institutions are preserved and political players learn to compromise, the societies that emerge should be far less unequal and therefore much more stable and better able to cope with other challenges.

While trade in illegal drugs is a political embarrassment and a social crisis in US, it is politically destabilizing and an existential threat to governments in Latin America, where institutions are fragile. How have Brazil and the US been cooperating to deal with this problem?

In the US in recent years there has been extensive debate on the policies for fighting drug trafficking. Slowly, old assumptions are being questioned and the country seems more willing to acknowledge that as a major consumer of drugs, its action or inaction at home has significant impact on other countries.

The US has expressed a desire to deepen coordination with Brazil to fight drug trafficking and other illicit cross-border activities, particularly in the area of information exchange. This dialog is increasingly fluid — for example, between Brazil's federal police and US agencies like the FBI and DEA. Brazil is also seeking to create new channels of communication, such as a central database on combating drug trafficking that would also be used by other South American countries.

The US has expressed a desire to deepen coordination with Brazil to fight drug trafficking and other illicit cross-border activities.

Clearly bilateral cooperation is fruitful, but it should not overshadow the political fact that fighting drug trafficking in South America must rely increasingly on the engagement of UNASUR member countries. The Brazilian government has often conveyed this view to the US, and the US has indicated agreement that South American countries should assume more responsibilities in policy discussions and take steps to combat trafficking.

The Free Trade Agreement of the Americas (FTAA) came to a standstill in November 2005 at the Mar del Plata summit. Meanwhile, the US has offered trade agreements that, while excluding Mercosur, are linking a large number of economies in the hemisphere, such as Chile, to the American model of free trade. What are the prospects for trade integration in Latin America?

The FTAA project went no further because the US removed from the negotiations most of the products (ethanol, sugar, orange juice, and steel, among others) and themes (cutting

farm subsidies, rules of trade, defense investigations, among others) that were of interest to Brazil. In the case of cutting subsidies and rules, the US made the process multilateral, transferring it to the WTO. The US also signaled its intention to list products in which Brazil was more competitive as sensitive and therefore outside the scope of tariff elimination. At the same time, the US sought to introduce into the agreement subjects of its own interest, such as intellectual property, investment, and services. Thus, the package that could emerge from the negotiating process would not meet the commercial interests of Brazil.

Regardless of the fate of the FTAA, trade relations between the two countries have been expanding. Vibrant trade between corporations and investment flows has deepened. In several segments Brazilian producers have become multinational, challenging the purely mercantilist logic that exports are positive and imports are negative. For example, a significant portion of US production of steel products, meat, orange juice, and textiles became controlled by companies capitalized by Brazilians. Similarly, in Brazil there is significant US participation in such industries as chemical, automotive, capital goods, and electronics.

Even without the FTAA and conclusion of the Doha Round — which would bring more balance to multilateral trade, with for example more precisely limited US farm subsidies — economic and trade relations between Brazil and US continue to deepen.

The historical challenge in Latin America, the source of almost all the other ills facing the region, is social inequality.

In this connection, what about current U.S. tariffs on Brazilian ethanol imports. How could Brazil and US increase their cooperation on biofuels?

The primary US rate on ethanol is 2.5% ad valorem; a secondary tariff worth 54 cents a gallon expires on January 1, 2011. The most likely scenarios are three: expiration of the tariff as scheduled; its renewal at the current value; or its renewal at 45 cents a gallon, on a par with the subsidy for blending ethanol with gasoline.

The US and Brazilian governments are making efforts to establish an international market for ethanol, encourage research, and promote biofuel production in other countries. The partnership of the two countries that are major producers and consumers of biofuels creates exceptional opportunities for joint action to promote sustainable use of energy, generate economic opportunities, and have positive social and environmental impacts. In 2007 Brazil and the US signed a Memorandum of Understanding to Advance Cooperation on Biofuels that has three components: bringing together research institutions and development of biofuels in both countries, such as the scientific cooperation agreement between the Petrobras Research Center and the US National Renewable Energies Laboratory; global cooperation to formulate international standards for ethanol and biodiesel specification; and finally cooperation in third countries, through which Brazil and the US work together closely to identify immediate opportunities for sustainable bioenergy, such as the current projects in El Salvador, Haiti, the Dominican Republic, and Senegal, among others.

Despite improved dialogue, there are areas of disagreement. Even though they both favor nuclear nonproliferation, they cannot agree on limits to Iran's nuclear program. Brazil maintains that the nonproliferation treaty allows use of nuclear technology for peaceful purposes; the US claims that Iran has already shown its intent to develop nuclear technology for military use. Similarly, though both Brazil and the US strongly favor democracy, in the American view, Venezuela is far from being a democracy, yet President Lula believes Venezuela has an "excess of democracy." How could Brazil and the US cooperate to resolve such international issues peacefully?

Though we have divergent views on how best to address the Iranian nuclear issue, we have never stopped discussing it. Brazil's position is based on three principles: defend the universal right to development and use of nuclear energy, in strict compliance with the obligations recognized in this area; reject any form of weapons proliferation; and give priority to dialogue and negotiation to achieve a peaceful and lasting solution to the Iranian issue.

It is on this last point that the difference in views is clearest. The US believes that the Iranians will only engage in frank and substantive talks if it is forced to, by strict penalties. Brazil said in the UN Security Council that additional sanctions will have precisely the opposite effect: the Iranians will pull away from the negotiating table. We believed that the Declaration of Tehran changed the situation substantially; it was clearly an Iranian gesture to build trust and restore conditions for negotiations.

We therefore opposed additional sanctions on Iran; and we regretted that this was the outcome. However, Brazil's policy is to scrupulously comply with UN Security Council resolutions, and obviously it has done so in this case. We believe that our negative vote makes it possible for us to maintain dialogue with both sides, and continue working toward a constructive solution.

With regard to democracy, both Brazil and the US agree that fully functioning democratic institutions are a key condition for a country to be part of the inter-American community. The inter-American system has procedures to deter attacks on the democratic order — with the requisite dose of respect for general nonintervention in domestic affairs. These were tested recently in the case of Honduras. We consider very positive the prompt unanimity with which our countries, including the US, rejected the coup, suspending Honduras from the OAS until democracy was fully restored. However, regrettably, we diverged about how to proceed with the elections. An opportunity was lost to demonstrate that elections cannot be used to sweep under the carpet the removal from office of an elected president, especially where free speech was restricted and human rights violated.

Recently, we conveyed to the US government the fears of several South American countries that the Honduras precedent might inspire antidemocratic circles in South American countries. I think we were able to make the US government realize the importance of the issue, and we pledged to continue talking about it.

Summing up: despite differences, we all learned important lessons from this episode that we can use in discussing ways to better use the mechanisms available.

INDUSTRY'S CHALLENGES: Innovation and competitiveness

Liliana Lavoratti, Rio de Janeiro

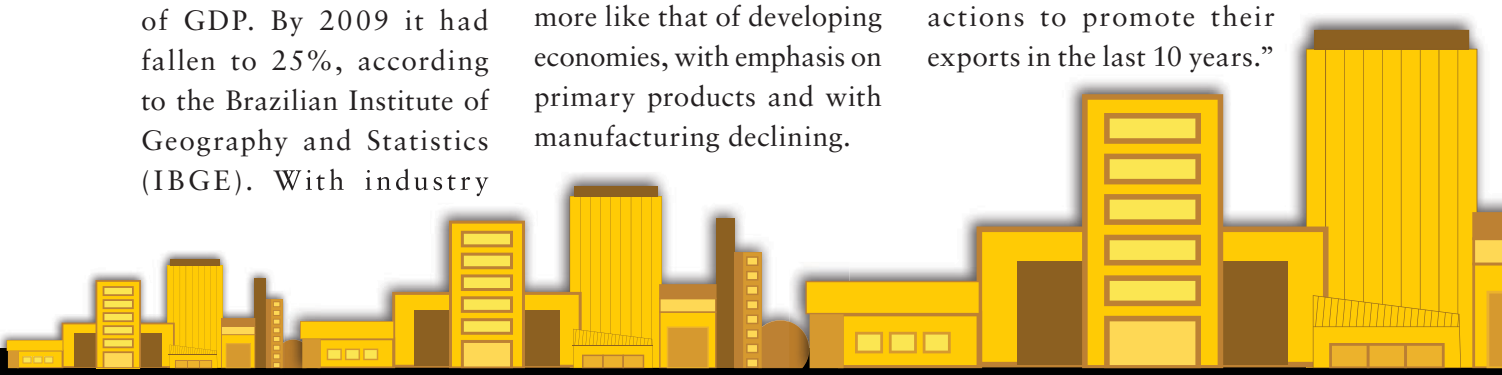
Since the late 1970s Brazilian industry has not had such a favorable situation for investment as today. The moment, however, comes with warning lights. The big question: Will the current course at last bring about structural changes that will give Brazil sustainable growth and a bigger and better position in world trade?

The share of industry in gross domestic product (GDP) peaked at the end of the "economic miracle" in the 1980s, when the policy of import substitution raised the sector's share to 37% of GDP. By 2009 it had fallen to 25%, according to the Brazilian Institute of Geography and Statistics (IBGE). With industry now maturing, it is time for more difficult choices. Both corporations and government need to focus on technological and institutional development to bring about the desired quality leap.

There are several complications. Apart from changes in world trade, especially with China affecting both demand and supply, some domestic factors could slow progress. There is a duality: although the profile of GDP in Brazil is closer to that of the developed countries — services already account for 68% of GDP — the profile for exported goods is more like that of developing economies, with emphasis on primary products and with manufacturing declining.

Unparalleled fall

The share of manufactured goods in total Brazilian exports has declined since 2007, a phenomenon that was accelerated last year with the plunge in global demand. "Even after taking into account the effects of the crisis, our exports with higher added value are likely to continue decreasing because we are losing competitiveness in this area," says Miguel Jorge, Minister of Development, Industry and Foreign Trade. "Another significant factor is the intensification of global competition," he adds. "Many players have adopted more aggressive actions to promote their exports in the last 10 years."



And the recovery of the US and European economies is still sluggish.

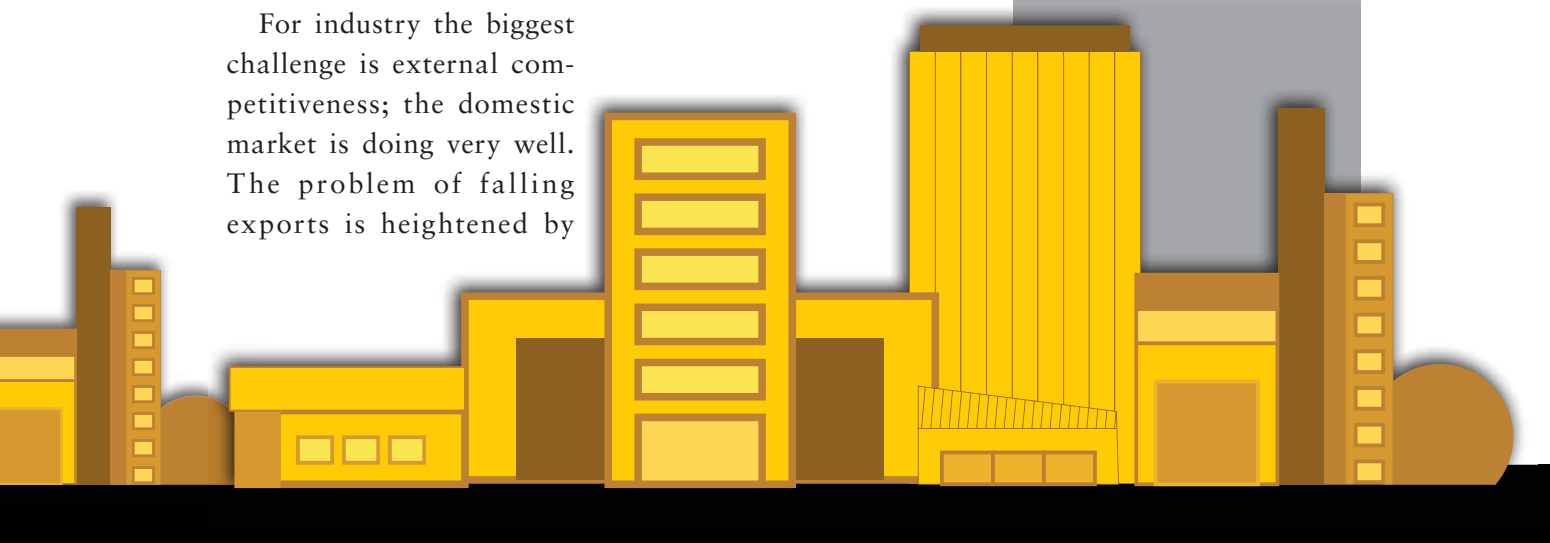
The chances are remote that much can be done about the appreciated exchange rate, one of the main factors that make Brazilian goods less competitive globally. The cost of money also remains high, though that does not prevent the extension of credit for consumption, says Renato Baumann, director of the Brazil office of the United Nations Economic Commission for Latin America and the Caribbean. He says, "The combination of these elements generates both positive and negative effects. On the one hand, it helps to sustain domestic demand, but on the other it is a model based on consumption rather than investment, especially in the public sector." A radical change in policy is ruled out by the major candidates to succeed President Luiz Inacio Lula da Silva in the October elections.

For industry the biggest challenge is external competitiveness; the domestic market is doing very well. The problem of falling exports is heightened by the need to improve the quality of manufacturing to ensure productivity in market niches. This requires clear regulations and technological innovation, among other advances. "Animal spirits abound in businesspeople, but typical problems persist, like the 'Brazil cost' reflected in the excessive tax burden and inadequate infrastructure," said Jose Augusto Coelho Fernandes, executive director of the National Confederation of Industry (CNI).

Search for identity

With what identity will the country expand its presence in world trade? "India has established itself in the international market as a software producer and exporter of talent. But what differentiates Brazil?" asks Lia Valls Pereira, coordinator of the Center for the External Sector of the Brazilian Institute of Economics (IBRE). Although Brazil is at the forefront of clean energy

The appreciated exchange rate is one of the main factors that make Brazilian goods less competitive globally.



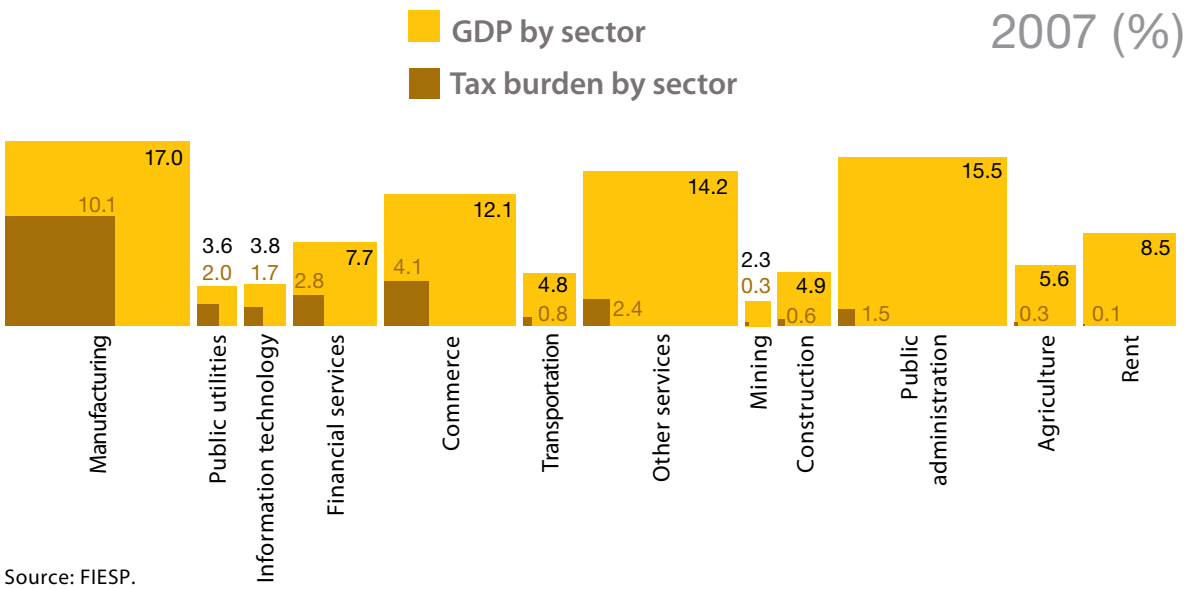
Brazil's manufacturing share in world exports has been virtually stagnant: it was 0.7% in 1980 and 0.8% in 2008.

production, use of ethanol as fuel, and predominance of hydropower, the country is not yet recognized worldwide as a major producer of clean technologies.

What is clear is that Brazil does not want to be Mexico. For a number of years, Mexico has attracted large amounts of foreign funds for production processes known as "maquillas" — assembly lines of manufacturing predominantly for export, with all the components imported. "Mexico's participation in world exports of manufactures grew, but the share of industry in GDP has not, because industry's value-added declined," Valls Pereira says. To avoid this in Brazil, past governments established minimum levels of national inputs for various industries.

What about Brazil's role as a world breadbasket? There is no doubt that selling commodities is important because it brings foreign exchange, but data from the World Trade Organization already show a decline in the share of agriculture in the world market, says Valls. Meanwhile, the share of processed foods has increased worldwide. Lately Brazil has been doing better in processed foods.

Like other diversified economies, Brazil has some advanced technology sectors but others are far behind. "In 60 years of industrialization, the country has succeeded in creating a production system with many virtues, but ... we depend too much on commodities, although producers have evolved in recent years," says Glauco Arbix, coordinator of the Innovation Observatory of the Institute of Advanced Studies, University of São



Source: FIESP.

Paulo. "In the past," he says, "cattle went overseas standing up on ships. Currently, Brazil as the largest exporter of beef and pork has sophisticated systems for slaughtering and distribution. But commodities are still limiting our economy."

Differences

Ricardo Sennes, partner at Foresight Consulting International, has questions about the decline of manufacturing exports. "When we look at sectors individually, significant differences can be detected. There is a direct correlation between a corporation's external competitiveness and a high standard of innovation in processes and products. This trend is growing and those who stay out of it suffer badly," he explains. The 10 Brazilian companies that registered more patents in Brazil and abroad in recent years have an international presence. "Some niches are doing well," Sennes says.

The decline in Brazil's manufacturing exports is different depending on the export market. Brazil's exports to South America are predominantly those with medium and high technological density, such as automobiles and textiles, while exports to the US and European countries have less technology content. Brazilian manufacturing exports to Europe are about 30% of total exports. Technological content and value-added plunge in what Brazil sends to Asia. The share of manufacturing in exports to China is close to zero — 68% are iron ore and soybeans, and the rest is orange juice and meats.

This phenomenon affects not only Brazilian products; China crowds out other countries in various markets, says Minister Jorge. In absolute numbers, Brazil's sales to the US grew steadily in the last 10 years, except 2009. But, he explains, "In 2010 we started to regain ground: in the first half, exports to the US rose 24% over the same period last year. But the relative share declined because exporters and government made a huge and successful effort to diversify the countries of destination of our foreign sales."

International integration

The share of manufactures in Brazilian exports increased from 45% in 1980 to 59% in 2000, then began to decline steadily. In 2009 it was 44% and from January to June 2010 it was 40%. The share of Brazil's manufacturing in world exports has long been stagnant: it was 0.7% in 1980 and 0.8% in 2008, according to the Foundation Center for Study of Foreign Trade.

Manufactured exports had a huge boost in Brazil in the 1970s and 1980s, when the government subsidized them and the policy of import substitution was observed.

For Baumann the question is not whether the increasing share of commodities in exports is good or bad for Brazil, but rather how to have

more efficient international integration. "There's nothing wrong with being rich in natural resources. Nordic countries generated wealth by selling natural resources and Latin America can find a good way to take advantage of its natural resources, too," he said.

David Kupfer, professor of economics at the Federal University of Rio de Janeiro, expands on Baumann's comments: "One of the major transformations of Brazil in the next decade will be integration into the global economy. Progress can occur not only with integrating global production chains, but also South American integration of regional production chains."

The internationalization of Brazilian companies should continue since so far it has occurred almost exclusively in just a few sectors: "It's one thing for the Vale Corporation to have a presence around the world. It's another for all export industries to achieve global presence."

According to the CNI, the increasing share of commodities in exports must be examined carefully. If Brazil finds markets for products at exceptional prices, it is natural that the export profile changes. "This is a spontaneous movement, and healthy," says Robson Braga, CNI president. "The concern is when we are faced with a decline in manufacturing exports because of internal dysfunctions or a highly appreciated exchange rate. That's why industry calls attention to the low level of savings, the excessive expansion of current government spending, high interest rates, and lack of investment in infrastructure."

China's factor

The problem is not just that the share of Brazil's manufactures in world exports has not increased. A real issue is the loss in manufacturing sales to a single competitor, China. China produces more than half of world production of crude steel and is moving into rolled and other sophisticated

BRAZILIAN EXPORTS BY TYPE

	US$ billion FOB	Share of total exports (%)		
		Commodities	Semi-manufacturing	Manufacturing
1964	1.4	85.4	8.0	6.2
1970	2.7	74.8	9.1	15.2
1980	20.1	42.2	11.7	44.8
1990	31.4	27.8	16.3	54.2
2000	55.0	22.8	15.4	59.0
2001	58.2	26.4	14.2	56.5
2002	60.4	28.1	14.9	54.7
2003	73.0	29.0	15.0	54.3
2004	96.5	29.6	13.9	54.9
2005	118.3	29.3	13.5	55.1
2006	137.8	29.2	14.2	54.4
2007	160.6	32.1	13.6	52.3
2008	197.9	36.9	13.7	46.8
2009	153.0	40.5	13.4	44.0
Jan.–Jul. 2010	89.2	43.4	14.0	40.5

Source: Ministry of Development, Industry and Foreign Trade.

steel products. "China is a fact that cannot be ignored," says Valls Pereira.

Brazil's share in total imports to the US has had a slight recovery, but the Chinese share has advanced much more, says Braga. "Only in two sectors of manufactured goods with greater technological content are Brazilian exports higher than Chinese: aircraft and other aerial devices, and weapons and ammunition. But in the case of aircraft Brazilian participation has been declining, while China's has increased slightly," he says.

Identity crisis

Just what is Brazil lacking? "We are the largest exporter of orange juice, but American consumers do not know that when they buy our juice. There is a need to create a Brazil brand. For soybeans it may be dispensable, but for machines and shoes it is essential," stresses Valls Pereira. Another step is to facilitate the access of small industries to foreign markets, and that will require official incentives. There are countless federal and state programs to encourage exports, but the results are questionable. She comments that, "Unfortunately, there are many ideas or programs, but these initiatives have not been assessed seriously." Excessive bureaucracy still prevents companies from enjoying the benefits of such programs.

Manufactured exports had a huge boost in Brazil in the 1970s and 1980s, when the government subsidized them under the Second National Development Plan, and the policy of import substitution was observed. Valls Pereira makes it clear that it is necessary not to repeat the past but to learn from it to implement effective programs to promote exports.

Initiatives

A long-term industrial policy could help. Some programs have been reactive rather than strategic. The acting president of the CNI, Robson Braga, praises the Productive Development Policy, announced in 2008, for being focused on annual actions to simplify and reduce the term of administrative procedures. Braga says, "The central problem is that the most important issues for the sector require an extraordinary effort of coordination between government agencies and government branches. Taxation, labor relations, and legal and regulatory frameworks must be adequate to provide vital business competitiveness."

Deindustrialization has occurred elsewhere in the world and usually goes together with increased exports of services. … Brazil has established itself as an exporter of services and should bet on service exports to offset the decline of manufacturing exports.

Minister Jorge highlights the resumption of the national debate on the need for an industrial policy with the launch of the PDP, after more than two decades without explicit policies for industrial development.

He said it is "a deep extension" of the 2004 Industrial, Technological and Foreign Trade Act, but there are still basic steps, qualification of a skilled workforce and tax reform, that "should be the focus of the next federal government, state governments, and Congress." In his opinion, "The world standard is no export tax of any kind, direct or indirect."

Braga says that CNI seeks to demonstrate that "having industry at the center of economic strategy is a way to grow more and better because it is the main source of technical progress, innovation, and productivity. But this does not require protection and encouragement of inefficiency. What we want is a level playing field: adequate infrastructure, good quality education, and mobilization of policy tools used by our competitors."

What's next?

Can Brazil become the fifth-largest global economic power in 2016 with industry's share of GDP at around 25% and exporting low-value-added commodities? "Why not?" asks Wagner Iglecias, professor of the University of São Paulo. "Do we necessarily have to tread the same path as developed countries 50 years ago? Is it not possible for a country to consolidate an economy that is at the same time rural and post-industrial, based on services and other assets?"

Brazil is competitive in a number of agricultural products that are responsible for the trade balance surplus, and its presence in world markets is also affected by subsidies and import barriers imposed by rich nations, Iglecias notes. In his view, the main issue is whether in the medium and long term there will be demand and prices for these products. "The situation in Brazil, compared to some neighbors, is privileged. Mexico exports agricultural goods, manufactured goods, and services, but it has only one customer, the United States. Venezuela has several business partners around the world but offers only one product, oil," he says. But Brazil has a diversified range of both export products and trading partners.

To Minister Jorge, the share of manufactures in exports is falling at a pace that should not affect the growth of the domestic economy. Moreover, Brazil is fully capable of making its industry more competitive and thus raising foreign sales of products with higher added value.

Sennes points out that deindustrialization has occurred elsewhere in the world and usually goes together with increased exports of services. "The higher a country's GDP per capita, the greater the share of the service sector in its economy," he adds. Brazil has established itself as an exporter of services — legal, engineering, infrastructure, design, information technology, and medical, among others — and should bet on service exports to offset the decline of manufacturing exports. "Of course industry still has an essential role in the strategic development of Brazil, but we need to think more broadly. Besides promoting the manufacturing industry, we should promote the Brazilian service industry," he recommends.

INNOVATION FOR THE FUTURE



Antonio Cruz / ABr

"If Brazil wants to consolidate its role in the international economic and political scenario it must give priority to science, technology, and innovation," says Minister of Science and Technology Sergio Rezende. He believes that the federal government has a fundamental role in the constant search for innovation and the expansion of the capacity of Brazilian companies and products to compete in world markets. For Rezende, Brazil is well able to produce knowledge and must now figure out how to use it to transform the way it does business.

Interview: Sergio Rezende, Minister of Science and Technology

Kalinka Iaquinta, Rio de Janeiro

The Brazilian Economy — **Where is Brazilian industry going?**

Minister Sergio Rezende — Brazilian industry should grow with the country's economy. However, it needs to be prepared to face the challenges of globalization, and the principal challenge is to add value to products to make them more competitive. This means that companies must make a great effort to incorporate technological innovation into their production processes. The Plan of Action on Science, Technology and Innovation (PACTI) and Productive Development Policy (PDP) sets out measures to stimulate innovation in businesses that have never been adopted in Brazil. But it is up to businesses to change their pattern of production.

How important is innovation for the industrial sector, which is aiming to achieve sustainable development?

Brazil's industrial sector has grown by importing technologies from elsewhere. What is necessary now is to build our capacity to produce knowledge and use our expertise to transform it into new businesses. This means generating wealth by incorporating knowledge into our other resources — natural resources, infrastructure, human capital, etc. It is necessary to turn the knowledge generated in universities and research centers into innovation. Knowledge makes it possible for Brazil to compete in international markets where product differentiation through technological innovation is the standard.

How can investing in research and innovation help create jobs and transform the economy?

If Brazil wants to consolidate its role in the international economic and political scene it must give priority to science, technology, and innovation. They are the pillars of development whose fruits should be distributed in a fair and equitable way. Brazil has a dynamic core of industries and businesspeople that are able to generate new knowledge. The government is very committed to creating a bridge between universities and corporations.

How much has been invested in public policy innovation?

Since 2006 subsidies have provided about US$1.7 billion to Brazilian companies, supporting such areas of knowledge and technology as information and communication technologies, biotechnology, nanotechnology, and health. In 2009, to reach the goal of the PACTI and the PDP to make small enterprises more competitive, 77% of the funds (about R$360 million, US$200 million) were allocated to projects submitted by small enterprises. With regard to

tax incentives offered by the 2005 Goods Law, the number of companies benefiting rose from 130 in 2006 to 460 in 2008 — a 240% increase. Investment in research and development companies that have benefited from the Goods Law rose from R$2.2 billion (US$1.2 billion) in 2006 to R$8.8 billion (US$5 billion) in 2008 (0.3% of gross domestic product). Today, according to the Brazilian System of Technology, we have 56 national networks, 20 technology services, 22 extensions arranged in the states, and 14 networks of innovation centers.

How does Brazil compare to the rest of the world in terms of investment in research and development?

Scientific knowledge in Brazil is relatively recent. Twenty-five years ago, the Brazilian scientific community had about 10,000 people with doctorates, of whom 8,000 were professors in graduate schools. Today, it has more than 80,000 people with doctorates; its scientific population is the largest and most qualified in Latin America.

It is well known that although Brazil graduates many engineers, there is still a shortage of professionals to respond to the demand that economic growth is creating. To meet this deficiency, we are increasing engineering scholarships to meet the PDP and other national strategic goals. We foresee an increase of 15% a year in the number of scholarships for these areas from the National Council of Scientific and Technological Development. The number of scholarships for graduate studies in engineering increased from 3,063 in 2007 to 3,297 in 2008 and to 3,702 in 2009. So between 2008 and 2009 there was growth of 12%, gradually approaching the 15% growth expected in PACTI.

What advances have been achieved in science and technology in recent years?

The government has given priority to science, technology, and innovation. The budget of the Ministry of Science and Technology (MST) will reach R$7.9 billion (US$4.4 billion) this year. Ministries and federal agencies together are effectively using the US$41 billion (US$ 23 billion) that was committed under PACTI for 2007–10. A significant advance was the implementation of the Sectoral Funds for Science and Technology. Congress has passed several other laws proposed by the MST that define the sources of new funds. The National Fund for Scientific and Technological Development has risen from R$350 million (US$196 million) in 2002 to R$3.1 billion (US$1.7 billion) this year. Another advance was to make innovation the core of the National Policy of Science, Technology and Innovation and the country's development. Efforts have also been made to have the states pass their own laws for innovation. By April 2010 14 states had already done so.

Knowledge makes it possible for Brazil to compete in international markets where product differentiation through technological innovation is the standard.

Does Brazil indeed have an industrial policy or do governments launch measures in reaction to problems, with no long-term planning?

The current policy expands the scope of actions already initiated and strengthens their relationship with other structural policies and their monitoring and evaluation. The challenges are to raise the innovation capacity of the productive sector and strengthen small enterprises. These are directly articulated in the PACTI commitment to promote technological innovation in enterprises.

CANDIDATE CAMPAIGN PROMISES

Thais Thimoteo, Rio de Janeiro

Businesspeople are wondering what the presidential candidates — Dilma Rousseff (Labor Party [PT]), José Serra (Brazilian Social Democratic Party [PSDB]), and Marina Silva (Green Party [PV]) — think about the future of industry, and especially what their policies are. Tax policy is once again considered a priority for the next government. For José Augusto Coelho, executive director of the National Confederation of Industries (CNI), to achieve tax reform, the next president "needs to be as energetic as US President Obama was to pass health reform."

So far the major candidates have presented only generic guidelines. Wagner Iglecias, professor of sociology at the University of São Paulo, points out that there has not been any innovative proposal: "Rousseff, as the candidate of the current administration, promises to follow the same model as President [Lula], focused on growth of the economy and the domestic market and strengthening some Brazilian companies to operate in the world market."



Marina Silva (PV)



José Serra (PSDB)



Dilma Rousseff (PT)

The main opposition candidate, Jose Serra, seems likely to carry on the agenda of former President Fernando Henrique Cardoso. Iglesias says that was important in the mid-1990s but could be considered out of fashion in today's post-crisis world. He also thinks that the PV candidate, Marina Silva, wants to mobilize the population for the difficult balance between economic growth and environmental preservation. "This may seem relevant to some Brazilians, but it is not a priority for most; the issue is distant from the immediate interests of the majority of the electorate," he says.

A meeting between industry representatives and presidential candidates the CNI sponsored in May allowed the three candidates to give businesspeople a few hints of their industrial policy. CNI tried to persuade the candidates to commit to the industrial sector, arguing that the country could double income per capita every 15 years if the barriers to industry were removed. Robson Braga, president of CNI, says there is no silver bullet solution: "There is need for sustained efforts to modernize the country's institutional framework."

STIMULUS

The presidential candidates agree with businesspeople about stimulating production for the domestic market and at the same time promoting exports — through tax exemptions, among other measures. According to Serra, it is also necessary to address macroeconomic factors, such as the overvaluation of the real against the dollar, that encourage imports, taking away jobs from Brazilians. "The Chinese enter the market, crowding out domestic production. Jobs are lost because of macroeconomic policy, which encourages the entry of imported goods and reduces the competitiveness of domestic goods," he says.

Brazil needs to ensure diversification and productivity, recovering ground lost in world trade in manufactured goods and also continuing to export commodities (iron ore, petroleum, agricultural products), Serra says. Rousseff promises government support for modernization of a diversified industrial sector capable of adding value to national production.

The three presidential candidates all consider current interest rates and exchange rates to be incompatible with sustained economic growth.

The presidential candidates also agree with business about the high tax burden. Rousseff says the tax situation is "chaotic." Serra agrees, commenting that "we have the highest tax burden in the world." Together taxes and social contributions amount to about 35% of gross domestic product (GDP). Silva is more cautious. For her, tax reform is possible, but expectations must be realistic. "If it was easy to do, it would have already been done," she concludes.

None of the candidates explained how they intend to overcome resistance from some political and business sectors, because while reducing the burden for some, tax reform would increase it for others.

INFRASTRUCTURE

Construction of new ports, airports, highways, and railways is essential to move Brazilian production efficiently, ensuring its competitiveness. Serra wants to improve infrastructure with support from private companies. "It's the lack of infrastructure that creates bottlenecks for future growth," he notes. Besides continuing the Growth Acceleration Program (PAC), Rousseff, the government's candidate, points out the importance of stimulating whole chains of production, especially for oil and gas. For her, the pre-salt oil field "is the passport to the country's future." Comparing the PAC to a "collage of public works," Silva says that her plan will be focused on infrastructure, with priority given to major projects like the World Cup in 2012 and the Olympic Games in 2016.

The presidential candidates were unanimous about improving public management. Silva wants to limit government spending to 50% of GDP growth in coming years. She also warns about the need to increase domestic savings. For Serra, the former governor of São Paulo, spending "less on public administration and more on the people" is essential to improving macroeconomic indicators. He says that at the federal level there are far too many people hired for commission positions. Efficiency will rise by lowering the public wage bill. Rousseff would prioritize the use of information technology in government activity.

The three presidential candidates all consider current interest rates and exchange rates to be incompatible with sustained economic growth. But, as with tax reform, none of them has so far explained how to lower the central bank benchmark interest rate and reduce the overvaluation of the national currency against the dollar.

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A forsaken village and election polls, 2006–08

Marco Antonio Villa

Canudos — founded by messianic rebel Antonio Conselheiro in the northeastern part of Bahia state in 1893 and destroyed four years later by government troops — continues to be abandoned by the government. The city was rebuilt in the early twentieth century, after the people returned. It remained isolated until President Getulio Vargas visited in October 1940 and the government decided to build a reservoir, which was completed in 1969, forcing the people of Canudos to move to the village of Cocorobó. Today Canudos county covers a substantial 2,985 square kilometers and has 15,636 inhabitants.

Bahia ranks near the bottom on the Human Development Index (HDI), 22nd among Brazil's 27 states, and Canudos is the poorest area in Bahia. Isolated by bad roads, without working telephone connections (mobile phones get no signal) and devastated by the drought (rainfall there is among the lowest in Bahia), the inhabitants of Canudos survive on the bare edge of poverty. The federal government is missing: there is only one branch of the federal government-owned Banco do Brasil, for instance, and it is open only a few hours a day.

The gross domestic product (GDP) of the county was slightly over R$39 million (US$10 million) in 2007, which gives a per capita income of R$2,716 (US$1,300). The number of workers in the formal sector is less than 200 (nobody can afford to pay even minimum wages). In the city, the main means of transportation is the motorbike (421).

The city depends heavily on the Municipal Participation Fund.[1] It receives about R$6.5 million (US$3.6 million) a year and expends R$11.5 million (US$6.4 million) a year. Tax revenue is minimal: the property tax brings in only R$4,000 (US$2,200). The county spends R$4.5 million (US$2.5 million) on civil servant wages, but only R$250,000 (US$139,000) on infrastructure. There are two hospitals, each controlled by one of the powerful oligarchs ("colonels") in the city. In one year there were 13,563 hospitalizations, an average of one per resident, even though the hospitals together have only 62 beds. This gives an average of 218 admissions per bed. None of the 13 Canudos doctors lives in the city.

The economy of Canudos is based on very low-productivity agriculture, raising

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goats, and small businesses. Despite the Cocorobó dam, which has the capacity to store 245 million cubic meters of water, half the homes in the city do not receive the precious liquid. Much of the water is salty, and the small area that is irrigated, serving 150 families, is in bad condition with ruined pipes. Average family income is about US$250 a month, equivalent to the income from the minimum wage, according to the researcher Luiz Neiva of the University of Bahia.

Although schooling indicators have improved, most young people do not have steady employment. When they work, they do odd jobs. There is no industrial, agricultural, or commercial activity that creates jobs in sufficient numbers to absorb the workforce. Leisure options are nonexistent, teenage pregnancy is considerable, and the only entertainment available consists of bars. On the main street, Juscelino Kubitschek Avenue, alone there are a dozen bars. Alcoholism and drug use are endemic.

In this microcosm of the Northeast interior President Luiz Inacio Lula da Silva won an easy re-election victory in 2006, taking 68.4% of the votes in the first round and 78.1% in the run-off. The opposition candidate running for president, Geraldo Alckmin, got 27.3% of the votes in the first round and 21.9% in the run-off. The Labor Party (PT) candidate Jaques Wagner running for state governor office won an absolute majority of votes, 54.7%, largely due to "Lula's surge."

The elections broke the dominance of two politicians who prey on the city, the current mayor from the Liberal Front Party (PFL) and former mayor from the Brazilian Social Democrat Party (PSDB). They had alternated in power since the county was created in 1985. In the presidential election in 2006 both supported the same candidate, Geraldo Alckmin, and were defeated.

The semi-arid Northeast has become (President) Lula's region.

What stands out is the number of voters: 10,655 out of a population of 13,760 people, far above the national average. In the 2008 election 9,427 electors cast votes for mayor — a very low abstention rate, just over 10%.

It is difficult to find someone who has not benefited from the Bolsa Familia (federal government food stamp program), the government program that pays allowances to poor families. In May 2006, in five months 1,673 families enrolled. By the eve of the election, that number had jumped to 2,246. Four years later, in May 2010, the program was serving 2,432 families, without any significant increase in the population. That is, the growth in those enrolled took place by increasing the number of those eligible who already lived in the city: "We have no jobs. I have three children. My husband just got a job now. Bolsa Família is good but I would rather have a job," says Maria José Varjão, 29, studying in the second year of high school. She voted for Fernando Henrique Cardoso in 1998, José Serra in 2002, and Lula in 2006. She was already enrolled in the social programs of the previous government. Of her six siblings, three migrated, two to São

Paulo and one to Salvador. She was able to build a house with the money one of them sends monthly. She lives next to her retired mother, and she has turned out to be the family breadwinner: "Bolsa Familia is the only guaranteed money the family has. My other two brothers do not have regular jobs," she says.

Teacher Maria Claudia Jesus da Silva, 26, was born in Canudos. She is single and has nine siblings. Five moved to the cities of Juazeiro, Petrolina, and Salvador "because there are no jobs here." Her father receives a pension: "without the retirement pension we could not survive." She has an aunt who has nine children and is already enrolled in Bolsa Familia. The teacher disagrees with the program. She says, "It's easy money," "no need to sweat." She adds that many who receive it do not work because they are lazy. She voted for Cardoso in 1998 and for Lula in 2002. This year she will vote for Lula's candidate again.

Father Livio, the Catholic priest, is an Italian who has lived in Canudos for several years. He believes that Lula has done little for the region. He complains about lack of investment. The presence of the government is seen only through Bolsa Familia assistance. He hopes the situation can be improved. The church has been very important in organizing the population to build water tanks, supporting preventive health programs, and encouraging family farming.

Without establishing a political dialogue with the millions who survive in the region, the opposition will suffer another defeat in the election next October.

The week before the second round in 2006 on a Saturday night there was even a motorcade in the city, with fireworks, obviously for Lula. Nobody said they would vote for Alckmin. The image the residents of Canudos had of the opposition candidate was of someone far removed from their everyday life. Many said they did not understand what he said, others only heard of Alckmin during the elections. They said that Lula was the only president "who looked upon us." They acknowledge the lack of jobs; talk about corruption ("everyone steals, but nobody has proved that Lula is a thief"); identify themselves with Lula's story ("he knows what drought is, what suffering is"); and related Alckmin to an old and powerful Bahian politician, Antonio Carlos Magalhães.

The semi-arid Northeast has become Lula's region. It is the only region that the official candidate, Rousseff, would win easily against the main opposition candidate, José Serra (PSDB). This is not accidental. Without establishing a political dialogue with the millions who survive in the region, the opposition will suffer another defeat next October. As a Canudos resident said: "I know that Lula will not be a candidate. I will vote for who Lula tells me to." ■

[1] The federal government provides funds for Brazilian municipalities through the Municipal Participation Fund, allocating shares mainly based on the number of inhabitants, which is estimated annually.