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Interview
Armando Castelar
Coordinator of Applied Economic Research, IBRE



THE BRAZILIAN ECONOMY

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REBALANCING BRAZIL'S ECONOMY WILL NOT BE EASY

The urgency of economic adjustment and an uncertain political situation will make 2015 a hard year for Brazilians.

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THE BRAZILIAN ECONOMY

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Photo: Rodrigues Pozzebom/Agencia Brasil.

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Cover Story

8 Rebalancing Brazil's economy will not be easy



Dramatic events in the second half of 2014 transformed the economic scenario at the turn of the year into a huge question mark. The main question is how President Rousseff will restore investor credibility, which is crucial to growth. That will require structural reforms as well as short-term measures. So far there does not seem to be a clear economic agenda. Solange Monteiro analyzes the pros and cons as experts see them.

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Armando Castelar, IBRE coordinator of applied economic research and former head of research for the National Development Bank (BNDES), explains to Solange Monteiro why in addition to fiscal discipline the government will need a clear vision and communicate broadly how it plans to restart growth. "We can expect at least two years of difficult macroeconomic news," he warns.

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Brazilian car industry's sales and exports fell sharply in 2014, and its problems are likely to continue into 2015. For one thing, the car industry is very sensitive to credit, and monetary and credit conditions are likely to tighten in 2015. Also, Brazil's car buyers are becoming more sophisticated. There is also a consensus among experts that to become more competitive in the global market, Brazil's car industry needs to innovate and lead technological research. Chico Santos reports.

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In the past 10 years, Brazil has invested heavily to make sure more Brazilian children are able to go to school. The problem now is the quality of those investments: Not using resources efficiently to improve the quality of education is a serious concern at a time when investment in public education is expected to surge. Fortunately, as Solange Monteiro discovers, school systems in Ceará and Rio de Janeiro states have come up with ideas that have proven to be effective and cost-beneficial.

From the Editors

THE GOVERNMENT HAS MADE a major move toward long-term fiscal sustainability in a package of measures, announced just before President Rousseff's second term began. It considerably tightened eligibility for Social Security and federal civil servant pension benefits for surviving spouses, unemployment insurance, and salary bonuses. The new economic team has also signaled that privileges and tax exemptions will be curtailed and taxes raised. Finally, on January 8, the government announced budget cuts worth US$8.4 billion in 2015. It appears that to improve credibility the government is determined to substantially increase the fiscal primary surplus of the consolidated public sector credibility.

That will not be easy. Federal government spending has been ballooning mostly because of surges in social spending, which the president is reluctant to cut. Meanwhile, the world economic outlook is not favorable, and investigations of corruption at state-owned oil company Petrobras that involve politicians could gridlock Congress, making it even harder for government to manage the economy (see the cover story, p.8).

In this month's interview (p.14), Armando Castelar, IBRE coordinator of Applied Economic Research, calls not only for government fiscal discipline but also for a clear vision of how to restart growth. That requires, he says, a positive agenda for, e.g., streamlining taxes and bureaucracy and accelerating concessions; he expects up to two years of difficult economic adjustment.

Among long-term pro-growth policies are improving the quality of education in general and expanding vocational training opportunities. Today more Brazilians are more educated than 10 years ago, but the quality of education has not progressed as fast as access to schools. These issues were discussed at the seminar on "Finance and Management of Education in Brazil," organized by the Brazilian Institute of Economics, are reported on p.24.



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ECONOMY

Retail sales rise for third month in October

Brazilian retail sales rose for the third consecutive month in October, at a seasonally adjusted rate of 1.0% from September, and rose 1.8% from October 2013, the government statistics agency IBGE said Friday. However, as employment has been losing steam, retail sales performance is unlikely to continue positive. (December 12)

Job creation fell 80% in November

Job vacancies totaled 8,381 in November, and new jobs dropped by 82% compared to November 2013, according to the Ministry of Labor and Employment. Layoffs in construction, followed by manufacturing and agriculture, more than offset new jobs in commerce and services. (December 18)

2014 vehicle sales worst in 12 years

Although elimination of industrial products tax (IPI) exemptions on vehicles as of January 2015 caused a rush to buy vehicles in December, which become the third best month in the history of the automobile industry, with 370,000 vehicles registered, the year ended with 3.5 million units sold, a decline of 7.1% for the year—the biggest drop recorded by the automotive industry in 12 years. The auto industry starts 2015 with high inventories and under pressure for losing IPI tax exemptions. (January 2)

First trade deficit in 14 years

Brazil registered its first annual trade deficit since 2000. The deficit hit US$3.9 billion, the Ministry of Trade said. As recently as 2011, Brazil had a trade surplus of US$30 billion. Exports were US$225 billion in 2014, down 7% from 2013. Imports were down US$229 billion, 4.4%, from 2013. Stalled trade negotiations, lower car exports to Argentina, slower world growth particularly in China, and lower commodities prices globally worsened the trade balance. The deteriorating trade balance weakened the Brazilian real as fewer U.S. dollars entered the economy. (January 5)

2014 inflation hits 6.41%

Inflation for 2014 was an estimated 6.41%, up from 5.91% in 2013 and barely within the government target range (2.5–6.5%), government statistics agency IBGE reported. The benchmark consumer price index accelerated to 0.78% in December from 0.51% in November, the steepest jump in nine months. Transport saw the biggest price rises in December. (January 9)

ECONOMIC POLICY

Central Bank more accommodative

Brazil's central bank has signaled it may slow monetary tightening at its next monetary policy committee meeting because it expects the government to limit spending and inflation to begin to ease. In the minutes of the last meeting, which raised the benchmark interest rate by 50 basis points to 11.75% to curb inflation and regain investor confidence, the bank hinted it may reduce the size of future rate increases, stating that it "anticipates that inflation is likely to remain high in 2015, but next year it should enter a long period of decline." (December 11)

BNDES interest rate raised

For the first time in more than a decade the government has raised the annual interest rate on long-term National Development Bank loans to business. In the first quarter of 2015 the rate will go up from 5% to 5.5% in an attempt to reduce subsidies to borrowers and improve government fiscal performance. (December 22)



Photo: Wilson Dias/Agencia Brazil.

Finance Minister Joaquim Levy has a difficult task ahead.

Primary budget deficit widens

In November the government primary budget deficit (excluding interest payments) was 8.1 billion Brazilian reais (US$3 billion). For the 12 months through November, the deficit was 9.2

billion reais—the first deficit in more than a decade. The government's 2014 goal was for a surplus of 99 billion reais. In November, the surplus goal was dropped to just 10 billion reais.

The overall budget deficit, which includes debt payments, was 41.6 billion reais in November. For the 12 months through November, the deficit was 297 billion reais, or the equivalent of 5.82% of GDP—the biggest since September 2003. In just a year, Brazil's gross public debt rose nearly 7 percentage points, to 63% of GDP. (December 29)

Government unveils budget cuts

The government announced budget cuts expected to total US$8.4 billion a year as it starts another year with the economy in the doldrums. Congress, currently in recess, has yet to approve the 2015 budget. Access to unemployment insurance is among the areas to be tightened. To restore market confidence, the goal of new Finance Minister Joaquim Levy is a surplus before debt servicing of 66 billion reais, 1.2% of GDP. (January 8)

POLITICS

Petrobras in hot water

President Dilma Rousseff has no plans to replace the chief executive officer Maria das Graças Foster of state-run oil company Petrobras, saying there was no evidence that senior management was involved in an emerging graft scandal, which has overshadowed debate about how Rousseff will manage the economy in her new term. Brazilian law enforcement is investigating allegations that former senior executives, construction companies, and politicians of Rousseff`s Workers' Party-led ruling coalition creamed billions of dollars off Petrobras contracts. The corruption network allegedly existed throughout Rousseff's tenure as chairman of the Petrobras board (2003–10). More than two in three Brazilians polled by Datafolha in December believe Rousseff has some responsibility for the corruption scandal. (December 22)



Photo: Rodrigues Pozzebom/Agencia Brasil.

Second-term President Rousseff and her mentor former President Lula.

Mixed messages on economic management

President Dilma Rousseff plans to restart economic growth by tightening Brazil's budget and increasing investment and productivity but claimed during her second-term swearing-in ceremony that "We will prove that economic adjustments are possible without revoking acquired rights or betraying our social obligations."

Since Rousseff, 67, took over from mentor Luiz Inacio Lula da Silva four years ago, the budget deficit has more than doubled, to 5.8% of GDP; and after hitting 7.5% in 2010 economic growth has come to a standstill. Rousseff, who won an Oct. 26 runoff election by the narrowest margin of any president since at least 1945, has appointed a new economic team and announced spending cuts. However, a day after new Minister of Planning Nelson Barbosa announced that the government would propose another adjustment in the minimum wage, Rousseff forced Barbosa to retract the statement; in the subsequent press release Barbosa stated that "the government's proposed minimum wage adjustment will follow the current adjustment rule." (January 3)

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REBALANCING BRAZIL'S ECONOMY WILL NOT BE EASY

The urgency of economic adjustment and an uncertain political situation will make 2015 a hard year for Brazilians.

Solange Monteiro

DRAMATIC EVENTS in the second half of 2014 transformed the scenario at the turn of the year in Brazil into a big question mark. The fierce presidential race, the deterioration of economic indicators, and allegations of corruption at state-owned oil company Petrobras heightened the already anxious expectations about 2015. Can the course of the country be corrected under the same leadership amid political tensions?

In the face of generalized skepticism, reelected President Dilma Rousseff has focused on reviving the government's credibility. To ward off the threat that Brazil will lose its international investment grade rating, the new economic team has proposed an ambitious fiscal goal: achieve a primary surplus of R$66.3 billion, 1.2% of GDP—R$55.3 billion to be contributed by the federal government and the rest by states and municipalities—even though the surplus in 2014 was zero. In contrast, IBRE is estimating a conservative primary surplus in 2015 of just 0.6% of GDP.

Though perhaps unrealistic, the initiatives were welcomed. "Ministers Joaquim Levy and Nelson Barbosa's message of greater transparency in public accounting, dismantling of expensive operations, reducing subsidies, limiting the operations of state-owned banks, and increasing savings to support sustainable growth is very positive," says Mansueto Almeida, Institute of Applied Economic Research (IPEA). But Regis Bonelli, IBRE coordinator of macroeconomic projections, noted, "It was only a speech. The challenge is just beginning." He believes there are still doubts about the scope of such a turnaround in economic policy.

Can the course of the country be corrected under the same leadership amid political tensions?

Revenues and expenses

The first impactful announcement was the tightening of pension benefits for surviving spouses, unemployment insurance, and salary bonuses for low-income workers; it indicated that

Brazil: IBRE baseline scenario for 2014-2016

	2010	2011	2012	2013	2014 Proj.	2015 Proj	2016 Proj
Real GDP growth (% change)	7.5	2.7	1.0	2.5	0.1	0.6	1.5
Inflation (% change)[1]	5.9	6.5	5.6	5.9	6.4	6.8	6.0
Central Bank policy rate (end-period. %)[1]	10.8	11.0	7.3	10.0	11.0	12.5	11.5
Exchange rate (average. Reais per U.S. dollar)[1]	1.8	1.7	1.9	2.2	2.4	2.8	3.0
Primary balance surplus (adjusted. % of DP)[2]	1.5	2.4	1.6	0.7	-0.6	0.3	1.2
External current account balance (% of GDP)	-2.3	-2.1	-2.2	-3.7	-4.1	-3.7	-3.2
Trade balance (US$ billions)[1]	20.2	30.0	18.0	2.6	-3.9	8.0	15.0
Export (US$ billions)[1]	202.0	256.0	243.0	242.0	225.0	214.0	235.0
International reserves (US$ billion)	288.6	352.0	378.0	373.5	381.0	370.0	370.0

Source: Brazilian Institute of Geography and Statistics, Central Bank of Brazil, IBRE staff projections.

[1]Actual values thru 2014.

[2]Recurring government primary balance surplus defined as budget balance excluding interest payments on public debt, extraordinary revenues from dividends and concessions, and some investments of the Growth Acceleration Program.

"Of the 5 percentage points of GDP increase in primary expenditure in the last 16 years, 4 percentage points related to transfers for social programs."

Silvia Matos

the government recognizes the pressure of social spending on the budget. "Of the 5 percentage points of GDP increase in primary expenditure in the last 16 years, 4 percentage points are related to transfers for social programs," says Silvia Matos, IBRE coordinator of macroeconomic projections. In announcing the measure, Planning Minister Nelson Barbosa said that it could generate savings of R$18 billion in 2015—about 34% of the total cost of these three social benefits.

Some economists question that estimate. Almeida says, "In the case of unemployment insurance, the calculation is uncertain because unemployment is expected to rise." IBRE researcher Gabriel Leal de Barros points out that those receiving salary bonuses and unemployment benefits together represent 40% of all recipients of public transfers in Brazil: "Today there are about 28 million beneficiaries, compared with less than 10 million in 2000." As for pensions for surviving spouses, IBRE staff estimates that the savings will be relatively small: R$940 million in 2016, rising to R$5.5 billion in 2019, at constant 2014 prices. Nevertheless, the decision to correct the excesses in the generosity of the Brazilian pension system is considered both right and bold.



Also on the expenditure side, economists are optimistic about a substantial reduction in subsidies, which in seven years have doubled to 1% of GDP. In addition to Finance Minister Joaquim Levy's hint that aid to the electricity sector will end, it is also expected that the low income housing program, My House My Life, will be curtailed. "The program has grown in recent years; it could be reduced to a size more compatible with the reality of the economic adjustment," Matos says. IBRE staff estimate that government contributions to My House My Life could decline from 0.35% GDP in 2014 to 0.20% this year.

Public investment could also be cut but, says IPEA's Almeida, "This is a measure that requires courage and high popularity, since it involves denying support to mayors and parliamentary projects."

On the revenue side, the controversy focuses on how much margin the government will have to increase the already formidable tax burden of 36.5% of GDP—about 3.0 percentage points higher than the average of OECD countries and 16.7 percentage points higher than the Latin American average. Almeida points out that raising taxes has been common practice in Brazil since inflation was stabilized in 1994:"Expenditure was previously financed by inflation, which has been replaced by tax revenue; during hyperinflation the Brazilian tax burden was 25% of GDP. Samuel Pessôa, IBRE researcher, believes raising taxes will be inevitable given the large imbalance of public finances. "Public expenditure has grown by 8% at constant prices since 1997, and for a long time for a number of reasons, revenues

grew in parallel," he says. Among the reasons were productivity gains that accelerated growth, and the commodity boom, which boosted collections of import taxes. "These factors no longer exist," Pessôa says. "What remains are a high primary deficit and explosive public debt."

Finance Minister Levy has not ruled out tax increases. Barros believes that type of initiative could be important if it targets tax exemptions granted in recent years. "Tax exemptions represented 0.1% of GDP in 2010 and 1.9% in 2014. That's a huge leap," he says. He identifies the main exemptions as payroll tax relief, the levy on payments to foreign suppliers of technology and technical assistance (Cide), the Tax on Industrialized Products (IPI), and the Tax on Financial Transactions (IOF), which applies to loans to individuals. Matos believes some of these exemptions have generated significant distortions in recent years.

IBRE estimates that for 2015 eliminating the Cide, IPI, and IOF tax exemptions could raise additional revenues of R$15.3 billion in 2015, and fewer investments and subsidies could reduce spending by R$27 billion. Cuts in salary bonuses and unemployment benefits would save another R$7.7 billion.

The government economic team would also like to reduce injections of Treasury capital into state-owned banks. At the end of 2014, the government raised interest and reduced the ceiling and maturities on loans made by the National Development Bank's (BNDES), aiming to gradually reduce Treasury's transfers to the BNDES. At the present juncture, it is known that any sudden move could generate adverse results. In the last seven years the Treasury's share in the capital of the BNDES shot up from 7.5% to 52.8% in 2014. Contributing less to state-owned banks' capital can only be positive, but although cuts

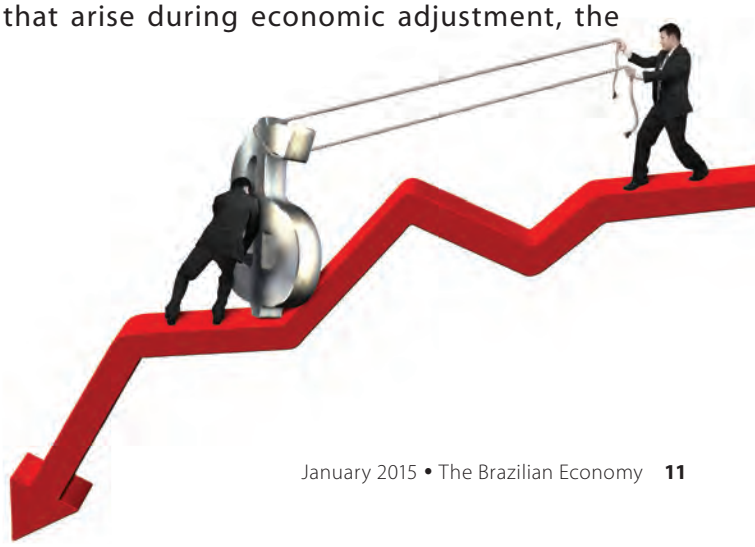
On the revenue side, the controversy focuses on how much margin the government will have to increase the already formidable tax burden—36.5% of GDP.

are necessary, support to state-owned banks should be lowered gradually because they are so dependent on Treasury funds and they have an important role in financing infrastructure projects.

IPEA's Almeida adds that central government spending is still growing faster than GDP despite Minister Barbosa's goal of limiting spending growth to GDP growth. "This year, we expect a rise in the minimum wage of 2.6% —much higher than expected GDP growth of about 0.5%. Since the minimum wage affects almost 50% of federal government expenditures, public spending will clearly grow above GDP," he says.

Political gridlock

Maintaining the discipline to carry out these measures, moreover, will be an endurance trial for the government. If successful, the effects of this effort in the short term will be negative, such as increased interest rates, less economic activity, higher unemployment, and falling real wages. "To deal with the social pressures that arise during economic adjustment, the



"We see a justified concern to act quickly to balance public finances, but we do not see a clear agenda for the administration's four-year term."

Claudio Dedecca

government will have to demonstrate its confidence in its economic team and sell its economic policy well," says economist José Marcio Camargo of the Catholic University of Rio de Janeiro. The government will have to persuade society to pay now to see economic growth resume in 2016. Almeida warns that "When it comes to adjustment almost everyone is in favor. But we do not know what will happen when, for example, the businessman knocks on the BNDES door and does not get the 80% credit expected, but only 50%, and has to chase more expensive funding. We should expect increased pressure on the government."

The government will also have to negotiate the approval of Congress for measures critical to the fiscal adjustment. "Any victory will be tight, since the Workers' Party lost 18 representatives and one senator in last year's elections," says Otavio Amorim Neto of the Brazilian School of Public and Business Administration of the Getulio Vargas Foundation (FGV). It will also be a test of the strength of the coalition supporting the government. Although President Rousseff is not accustomed to making political deals, she is aware of the current political situation. Pessôa points out that the ministers appointed suggest that more power will be shared within the coalition than in the president's first term. But it remains to be seen whether the opposition will be willing to support the government on initiatives that it considers consistent with its agenda. Another factor that may create uncertainties for fiscal adjustment is the investigations into the kickback scheme at Petrobras: since this involves politicians, it could complicate Congressional voting on vital economic measures.

Pro-growth policy

The government announced budget cuts expected to total 22.8 billion of reais (US$8.4 billion) early this year. The announcement of cuts in non-priority discretionary spending is very positive and a step in the right direction; however, new tax and fiscal measures will be required to achieve the target of 1.2% of GDP," said Barros. However, Matos points out that in the event that the government fails to meet the 1.2% fiscal primary surplus goal, but it carries out the principal measures firmly, it should meet with market approval. "No one is expecting miracles, and the economic team can still have the benefit of the doubt; the important thing is the certainty of the policy course," she says. She notes, however that the government has yet to spell out clear policies for resuming growth. Barros adds that "Fiscal adjustment is the most urgent issue at hand—but without a growth strategy it will be much more difficult to reach the 2% primary surplus target for 2016."

Barros highlights the need to tackle the productivity issue by making investments in infrastructure and education in a priority. "It is also necessary," he adds, "to think about reversing government micromanagement of the economy —such as fixing rates of return for concessions and the use of tax policies as a tool to control prices—and establishing clear guidelines and predictability for economic policy."

Although the government acknowledges the importance of productivity and infrastructure,

it has yet to draft clear guidelines on how they will be addressed. "It's a complex policy agenda, and I do not see that it has been discussed as it should," said Matos. Economist Claudio Dedecca of the University of Campinas agrees: "We see a justified concern to act quickly to balance public finances, but we do not see a clear agenda for the administration's four-year term."

Camargo sees a historical lack of long-term thinking, pointing out that "In Brazil, we see growth as the agenda for tomorrow. It is not. Growth is a long-term agenda, which demands reforms in the labor market and credit market, reduction of state participation in the economy, and tax and political reforms. Structural reforms are needed to revive credibility for Brazilian policies. Short-term measures will not work."

Dedecca argues that, along with economic adjustment, a positive government initiative would be to lay out for society and Congress the strategic issues and stimulate debate to gain support and legitimacy for carrying out decisions. "In recent years," he explains, "we have seen the country call for political and tax reforms that have not yet been mentioned by ministers, despite being essential for the resumption of Brazilian development." He argues for transparent monitoring of policy implementation to support discussion and policy revision. Barros agrees: "In general, we do not evaluate the results of public policies. This should be included in government multiyear plans."

IPEA's Almeida points out that these first announcements of the economic team do not make clear what support the government will provide to industry. Renato Fragelli of the FGV Graduate School of Economics adds that "We have deep inefficiencies and structural problems affecting industry as well as a tendency to raise taxes. Sectors like agribusiness can survive even if you tax them. But industry won't survive if you tax it too much. In Brazil, the only industries that can definitely survive are those focused on the domestic market, using average technology—not exporters of industrial products."

"Growth is a long-term agenda…. Structural reforms are needed to revive credibility for Brazilian policies. Short-term measures alone will not work."

José Marcio Camargo

The economic outlook for 2015

Compared to 2014, IBRE staff forecast GDP growth of 0.6% in 2015, with increased activity in agriculture and the electricity sector compared to 2014, and a slight increase of 0.1 percentage points in the services sector. Expected to improve their results but remain in negative territory are construction, at –1.2%, and manufacturing at –1.6%.

José Julio Senna, IBRE coordinator of monetary studies, does not believe that more severe monetary policy will be used to contain inflation, which is projected for most of the year to be close to 7%. He predicts that "The government will use monetary policy sparingly, relying more on fiscal tightening." IBRE is forecasting an exchange rate of R$2,80 per US dollar in 2015 and R$3,00 in 2016.

In the new scenario of low oil prices, in the short term the economic effects should be positive, since Brazil is a net importer of oil and oil products. Lower prices for oil and its derivatives would therefore help to reduce the external current balance deficit and eliminate the need for significant adjustment in fuel prices. However, over time they might have a negative effect on investment in deep sea oil exploration.

Photo: IBRE



"Brazil will have to undergo a profound transformation"

Armando Castelar

Coordinator of Applied Economic Research, Brazilian Institute of Economics, Getulio Vargas Foundation

Solange Monteiro

THE POLITICAL AND ECONOMIC uncertainties that besiege the beginning of President Dilma Rousseff's second term suggest that 2015 could be a year to forget. Armando Castelar, IBRE coordinator of applied economic research and former head of research for the National Development Bank (BNDES), points out that in addition to fiscal discipline the government will need a clear vision and message on how to restart growth."Today the only economic news is bad news, and this will make things worse because the economic adjustment will be slow. We can expect at least two years of difficult macroeconomic news," he says. Castelar emphasizes that it is imperative that the government have a positive agenda of reforms focused on streamlining taxes and bureaucracy and accelerating concessions, among other items. "To accomplish this, however, the government needs to reject ideology. And we see no clear signal of this happening so far," he says.

***The Brazilian Economy*—A few months ago, expectations about 2015 focused on what fiscal adjustment the new economic team would make. However, unfolding investigations into a kickback scheme involving Petrobras management, politicians, and vendors have added further political instability. How will this affect the economy?**

Armando Castelar—Some time ago we predicted that 2015 would be a difficult year. Economic policy mistakes have been building up and

they could not be corrected before the elections. … Moreover, China has slowed, which means less favorable commodity prices for Brazil, and the United States is accelerating, which means higher interest rates for Brazil. …

It appears that 2015 will be even harder than we expected.First, the necessary economic policy adjustments were exacerbated in an election context. Second, the Petrobras issue is very serious from both a political and an economic point of view. It is compromisi ng the health of the country's whole oil and gas sector. As Petrobras is stripped of cash, it may affect payments to suppliers, and the entire supply chain that depends on Petrobras. Also, until Petrobras can publish its balance sheet, it cannot borrow money to invest—and Petrobras is responsible for a significant share of fixed investment in Brazil. And finally, what is happening with Petrobras may make it even more difficult for all oil sector companies to borrow money abroad. Today the international financial market is already keeping emerging exporters of commodities at arm's length because of low commodity prices. When you add what is happening with Petrobras, no one wants to get involved with Brazil's oil sector. Another question is how infrastructure works will be affected, given that some large building companies are involved in the Petrobras scandal.

Some compare the challenges of 2014 to the ones of 2003, the first year of the Lula administration. Do you agree?

The current situation is similar to 2003 because inflation was high. But it is much more difficult. In 2003, the problem was related more to concerns about what as president Lula would do. As a result the exchange rate depreciated a lot, driving inflation up and consequently raising public debt, which was largely denominated in US dollars. When Lula took over, he adopted policies even more orthodox than his predecessor, President Fernando Henrique Cardoso, increasing the primary budget surplus and raising the interest rate sharply. In six months, however, people were convinced that there would be no dramatic policy change; he would follow the economic policy inherited from Cardoso. So the currency strengthened against the U.S. dollar, bringing down inflation and public debt. It was relatively quick, and relatively painless. In 2003 there was no need to correct controlled prices, as there is in 2015. The Cardoso administration had corrected controlled prices in 2002. Now, however, we need to curb services inflation to make up for higher controlled prices and the exchange rate devaluation. However, bringing services inflation down will necessarily increase unemployment and reduce income. … This is much

China has slowed, which means less favorable commodity prices for Brazil, and the United States is accelerating, which means higher interest rates for Brazil.

Until Petrobras can publish its balance sheet, it cannot borrow money to invest—and Petrobras is responsible for a significant share of fixed investment in Brazil.

harder to do; it will directly affect the well-being of families. It is a different situation from 2003. The social cost will be much higher because it will take longer to reduce service prices. And you have a much more complicated political situation than in 2003 … At that time President Lula skillfully blamed the previous government for the difficult situation. This is not possible now; the Workers' Party has been in power 12 years. … And President Rousseff today is much more committed to ideological issues.

Do you think that an intensified political crisis could jeopardize Congressional support for the economic adjustment?

In her first term, particularly in mid-2013, President Rousseff was very popular. This made it easier to deal with Congress. The situation now is different. Her election victory was tight, and the difficult economic situation and the Petrobras scandal may affect her popularity. This will require greater ability to manage the party coalition, and it is not clear to me how this will be done. On the other hand, I do not think the major measures that need to be made require congressional approval, and in times of crisis governments can usually approve things more easily. I think many of the measures to be taken to clean up public finances will not need opposition support—I do not believe that there will be a governability risk.

Considering the complex scenario for economic adjustment, what are the growth challenges this year?

It is not simply a matter of economic adjustment—bringing inflation down, in an economy that has been overheated. Brazil will have to undergo a profound transformation in its consumption-led growth: both private and public consumption are at a very high level, totaling 85% of GDP over the last four quarters. … Domestic saving is 13% of GDP, the lowest level since the 1950s. That all has to change. We have to move to investment- and export-led growth. That will not be a trivial process. It involves restoring business confidence to invest and improving the competitiveness of exporters.

Macroeconomic adjustment is part of this process, but if we do not address other growth-related problems the speed and the extent of the economic recovery will be less. There are many obstacles to investment that are not macro-related, such as complex tax laws, infrastructure, labor regulations, and bureaucracy. It is essential that the government not get stuck on macroeconomic policies. … The government urgently needs to build a positive policy agenda, starting with streamlining taxes and bureaucracy, labor reforms, and accelerating infrastructure concessions and public-private partnerships.

What about the external outlook?

The United States is clearly recovering. The question is how lower oil prices will affect the US economy, which varies between slightly good to very good. Americans spend much on fuel, cars, and heating, and a fall in fuel prices means that people have more money to spend. On the other hand, since today the United States also produces a lot of oil and many of the jobs created recently have been in major oil-producing states, lower oil prices may reduce growth a bit. Still, I believe on balance lower oil prices will help the United States. The U.S economy will continue accelerating, and interest rates will rise in 2015. This is generating great turmoil in international financial markets, with the currencies of commodity-producer countries such as South Africa and Russia devaluing a lot. In Japan, Shinzo Abe's election victory will give new stimulus to the country. Japan has a yen devaluation policy, and Japanese industry is becoming very competitive. … The difficulty Europe has in making major monetary easing as Japan is doing will bring about relatively weak growth. China's growth has slowed to 7%, where it should stay for some time. It is still a good performance; there is no crisis there.

And emerging countries?

Countries like India and Indonesia will gain from the oil drop. For some time India's economy has had very high external current account deficits. With the fall of oil prices, the deficit will disappear. With a new prime minister who is apparently quite committed to addressing the size of government, and lower oil prices, the country should do relatively well. South America

Brazil will have to undergo a profound transformation in its consumption-led growth: both private and public consumption are at a very high level.

is feeling the drop in commodity prices. The economies of Peru, Chile, and Colombia have slowed from 5–7% to 3%. [Because of economic policy mistakes,] Venezuela and Argentina are in a much worse situation. … Argentina has elections next year and is more likely to get out of its trap. Venezuela's political situation is more complicated. Mexico is closely linked to the US economy, and should benefit from US recovery. On the other hand, it is still seen as an oil economy. The world will continue to grow slowly, but with different stories for different countries.

How do you think the economic team will manage the exchange rate against a stronger U.S. dollar?

The exchange rate has been significantly devalued. However, it is likely that the economic team will have difficulty in carrying out all the needed price adjustments in 2015. … If the government adjusts controlled prices and lets the exchange rate devalue, it will be correcting a distortion in the economy that has lasted too long. Central bank policy of selling large amounts of foreign exchange

In the long run devaluation of the exchange rate will be good for industry. However, in the short term it will benefit industry less because imported inputs will be more expensive.

swaps until recently prevented the exchange rate from devaluing more [and helped to contain inflation]. It will be hard to continue this policy as the US dollar strengthens. I believe the central bank will let the exchange rate devalue, and consequently let inflation rise. Inflation in 2015 will be the fault of the departing economic team. The question is whether the government will have the will to actually contain inflation.

How will exchange rate devaluation affect industry and exports?

In the long run, of course, devaluation of the exchange rate will be good for industry. In the short term industry will benefit industry less because imported inputs will be more expensive. But on balance exchange devaluation will be positive. The projected trade surplus for 2015 is mainly attributable to falling imports. We do not know how much commodity prices will fall this year. … Let's see what will happen; this story of falling oil prices is frightening.

What reforms are needed?

In times of crisis it is good to make major reforms—reforms are important for society as a whole to get out of the crisis—but reforms cause problems for vested interests. There is room to make such reforms as accelerating the granting of infrastructure concessions, simplifying taxes, and amending rules, particularly the ones that make Petrobras the only operator of oil concessions, to foster more activity in the oil sector. Again, the government has to have a positive agenda for reforms, including improving investment and the business environment to encourage growth. Also, the government will have to communicate its pro-growth policies more clearly. Today the only economic news is bad news, and this will make things worse because the economic adjustment will be slow. We can expect at least two years of difficult macroeconomic news.

What reaction do you expect from society?

I believe there will be more active popular participation because the standard of living will decline. Households have high debts and their earnings will stop growing, and possibly even fall. They will have to cut spending, struggle to borrow again, and honor their debts. … We will witness more social unrest … Therefore, the government urgently needs a positive agenda of reforms that provide hope beyond the difficult years ahead. For this, however, the government needs to reject ideology. And we see no clear signal of this happening so far. ■

What's driving the automotive industry?



Chico Santos

THE BRAZILIAN CAR INDUSTRY had a difficult 2014. Despite strong encouragement from the federal government through reduction of the Tax on Industrialized Products (IPI), vehicle production fell by 23% in 2014. Although we do not have numbers for the whole year of 2014, numbers for the first half of the year suggest that possibly Brazil's car industry lost seventh place among the world's largest car producers to Mexico. According to the National Association of Vehicle Manufacturers (Anfavea), last year Brazil produced 3.2 million vehicles compared to 3.7 million in 2013.

Although Anfavea president Luiz Moan Yabiku Jr is optimistic that the improvement in sales in the second half of 2014 will continue in 2015, the car industry is very sensitive to credit, and monetary and credit conditions are likely to tighten in 2015. At year end in 2014 central bank's

basic interest rate was 11.75%, having risen 0.50 percentage points in October and 0.25 in December.

The challenge for the auto industry is to continue growing and, as the government wishes, lead innovation and technology development in the Brazilian industry, and become more competitive in the global market. The controversy is about whether this can be achieved.

The National Development Bank (BNDES), the largest lender for long-term investments in Brazil, has been pouring financial resources into car industry modernization. From 2008 to September 2014 the institution approved R$44.8 billion to fund sector projects, of which more than 10% was for research and development (R&D) and engineering projects. According to BNDES, the outcomes so far justify its support for the car industry.

For instance, the number of engineers in relation to all employees in the car industry grew from 3% in 2008 to 4.3% in 2012, reducing the gap with the United States, where engineers constituted 5.9% of total car industry employees.

Another outcome, BNDES reported, is that carmakers themselves invested R$58 billion in 2010–13 and they are expected to invest another R$59 billion in 2015–18. According to Anfavea, auto and auto parts manufacturers committed to invest R$77 billion in 2013–2018 under the federal Program for Incentives to Technological Innovation and Densification of the Motor Vehicles' Productive Chain (Innovate-Auto). The Innovate-Auto program, created in late 2012, allows a reduction of up to 30 percentage points in the IPI tax on goods used for investment in innovation and production of motor vehicles and parts.

"The market must live with a new attitude among Brazilian consumers, who closely compare cars produced here with cars produced in Europe."

Luiz Carlos Mello

"What we need is a determination to move forward with technological development, not just with government stimulus but also Brazilian entrepreneurs embracing full-heartedly competitiveness," says Luiz Carlos Mello, former president of Ford Brazil (1987-1992) and today director of the Automotive Research Center (CEA Autodata). He believes the car industry has great growth potential.

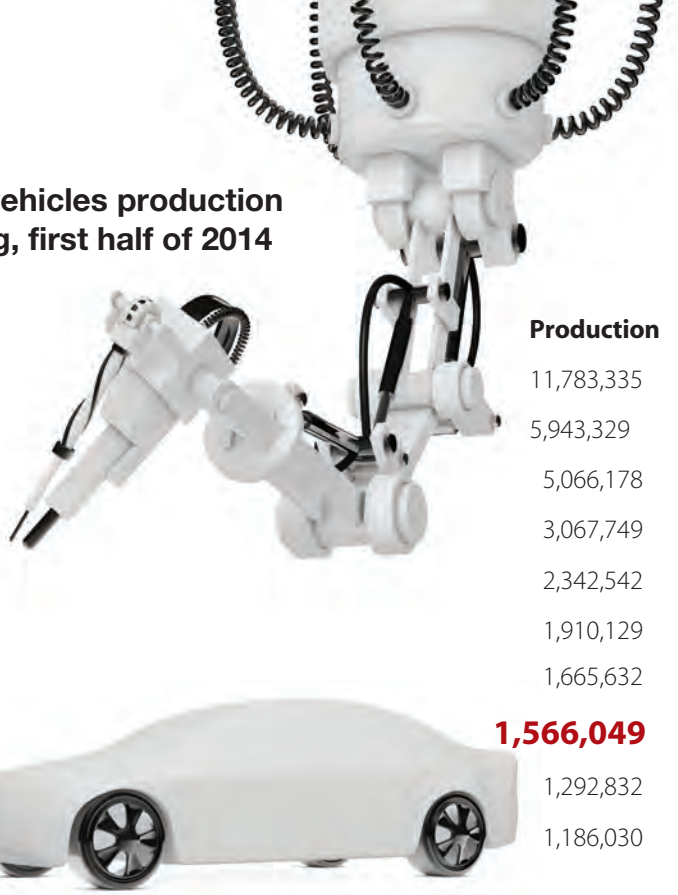
"Brazil, like China, India, and Russia, is a virgin market," he says, with great potential for growth and development. Anfavea estimates that by 2034 the Brazilian market will expand from the current annual 3 million vehicle licenses to 6.9 million. Mello points out that it took Brazil less than two decades (1992–2010), to achieve annual production of some 3 million vehicles, while France, Germany, and the UK took much more time to reach that production.

Although China, now the world's largest carmaker, has been advancing dramatically since the 1980s, Mello believes that Brazil has some advantages, such as the fact that it is the only emerging country to have accumulated car manufacturing experience over 50 years.

Thus, the current economic situation of the Brazilian car industry, Mello says, has nothing to do with a shrinking car market. However, he points out that "the market must live with a new attitude among Brazilian consumers, who closely compare cars produced here with cars produced in Europe."

Mello points out that automakers took the risk of increasing their capacity, supported by government tax incentives and cheap BNDES financing, because they recognize that the domestic market has vast potential.

Externally, vehicle exports fell by 41% from January to November 2014 compared with the same period a year earlier, mainly because of the economic crisis in Argentina, Brazil's principal car market. Mello sees no prospects of a short-term



World vehicles production ranking, first half of 2014

	Country	Production
1st	China	11,783,335
2nd	US	5,943,329
3rd	Japan	5,066,178
4th	Germany	3,067,749
5th	South Korea	2,342,542
6th	India	1,910,129
7th	Mexico	1,665,632
8th	**Brazil**	**1,566,049**
9th	Spain	1,292,832
10th	Canada	1,186,030

Source: International Organization of Car Manufacturers (Oica).

alternative that can replace Argentine vehicle purchases. Also, "the headquarters of international carmakers do not allow their affiliates in Brazil and elsewhere to export wherever they want," he says. He points out, for example, that Ford EcoSport cars sold in Europe are manufactured in India, although the model was developed in Brazil.

Employment policy

Carlos Frederico Rocha, director of the Economics Institute of the Federal University of Rio de Janeiro and a specialist in the industry, has a more critical view of the auto industry: "The Brazilian automotive industry is important for generating employment and economic activity but will not lead technological development ," he says, adding that government tax incentives constitute "employment policy, not industrial policy."

Given the legal and bureaucratic difficulties in carrying out an employment policy through public investment during the current economic slowdown, Rocha believes that stimulating the auto industry is "a simple way" to increase jobs.

"Would it not be better to transfer these investments to urban mobility?" Rocha asks, noting the problems piling up in big cities as the private vehicle fleet expands faster than roads. But in general, he notes, public works are subject to bids and extensive control mechanisms, and they generate few permanent jobs.

With regard to developing technology for itself and stimulating technical development in the economy as a whole, Rocha believes that in the automotive industry domestic capital has failed to partner with foreign capital to reach that goal.

What happened was that large international companies absorbed domestic R&D initiatives and centers for creating technology remained outside the country. Rocha said there had been technologically important national companies, such as Metal Leve, a maker of pistons and bearings that was sold to German Mahle in the 1990s. "Maybe if we had done 'joint ventures' as was done in the petrochemical sector ..." Rocha speculates.

"We were able to create an aircraft industry, why were we not able to have a car industry?"

"The Brazilian automotive industry is important for generating employment and economic activity but will not lead technological development."

Carlos Frederico Rocha

Rocha asks. He thinks that, with few exceptions, such as the current innovation policy, which he considers good, Brazil's industrial policy has not been effective.

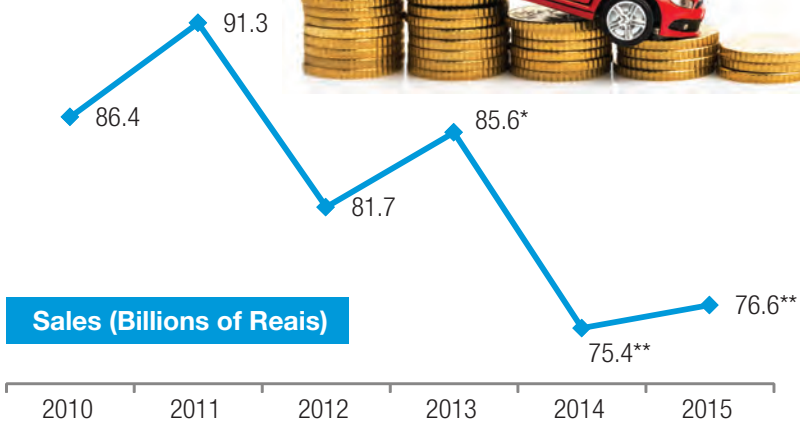
However, "Overview of Automotive Engineering in Brazil: Innovation and BNDES Support," a study by BNDES staff members Bernardo H. Ribeiro de Castro, Daniel C. Barros and Luiz Felipe H. Vaz, argues that automotive R&D and innovation is ahead of Brazil's manufacturing industry as a whole. According to government statistics agency figures, while manufacturing as a whole invested only 0.7% of net operating revenues in R&D and 2.5% in innovative activities, automakers invested 1.4% and 2.8%. Among suppliers of parts, investments in R&D were also above the average for all industry, accounting for 1.2% of net revenue.

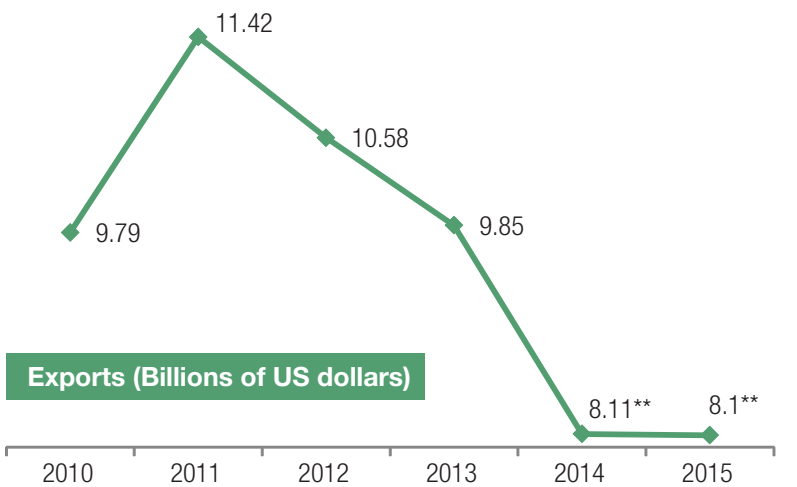
Though the study argues that the BNDES is doing the right thing in supporting the build-up of a sophisticated auto industry that can lead to technological advances, the authors admit that "Although one can cite examples of vehicles designed in Brazil, such as the Volkswagen Fox and the new Ford Ka and Ford EcoSport, most engineering effort continues to focus on adapting global car models to local conditions"—development of components and complex systems remains at the headquarters of international companies.

After highlighting current auto industry achievements, the study also cites such deficiencies as the low number of Brazilian engineers in relation to the population as a whole and insufficient engineering infrastructure to support development of the auto industry.

Brazil: Sales and exports of auto parts



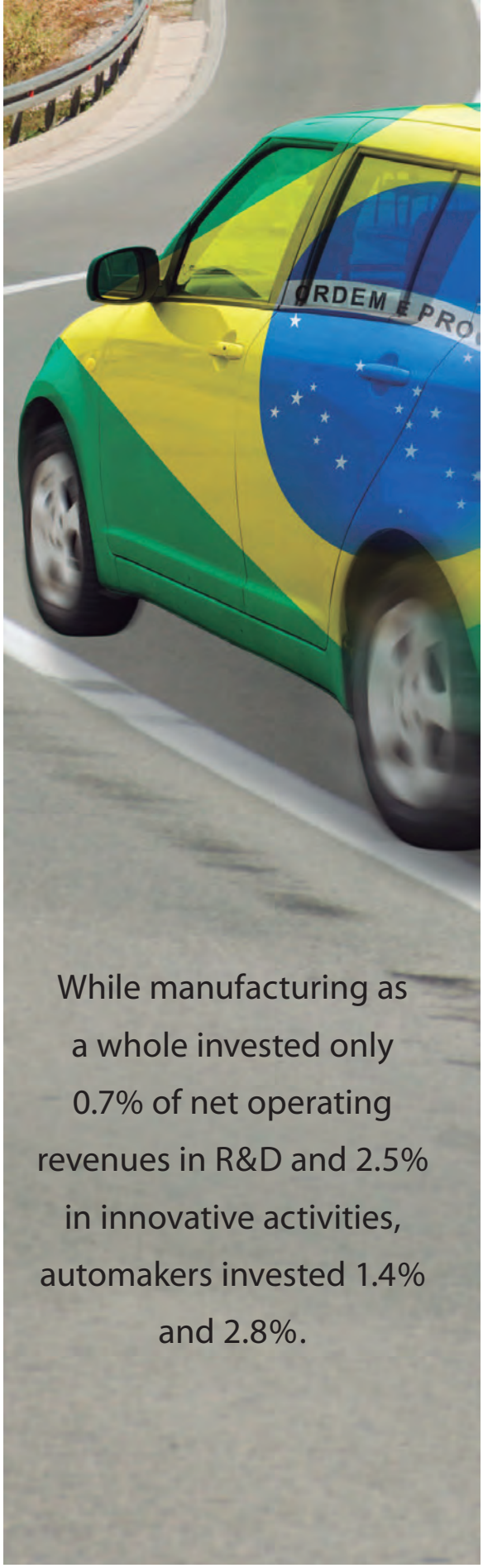




*Estimate **Projection.
Source: National Union of Auto Parts Manufacturers (Sindipeças).

Costs and benefits

Rogério César de Souza, chief economist, Institute of Studies for the Development of Industry, believes 2015 will be as difficult a year for the auto industry as 2014 was. The need for intensive fiscal and monetary tightening to control inflation and regain the confidence of investors will have a negative effect on the auto industry.



While manufacturing as a whole invested only 0.7% of net operating revenues in R&D and 2.5% in innovative activities, automakers invested 1.4% and 2.8%.

However, he also believes the auto industry has to address specific factors to contribute more to development of Brazil in the future. One is that there is no longer much room for such tax incentives as reduction of the IPI tax. "The positive effects of tax incentives are no longer as clear as they were in 2009 and 2010," he says. Before granting future incentives to the sector, he recommends assessment of the costs and benefits to society as a whole. "The costs everyone knows. What is not clear is the expected benefit to society," Souza says. He believes a new industrial policy may emerge from the Innovate-Auto program, which will allow society to see the benefits and know how the auto industry fits in the larger industrial context. Though not as populous as China, he points out Brazil's per capita income is still well above China's, making it a market where everyone wants to be.

The Innovate-Auto program is also seen as a way to stimulate recovery of the auto parts supply sector. According to Paulo Butori, president of the National Union of Auto Parts Manufacturers, 2015 will be about the same as 2014. Sales of auto parts dropped by R$10 billion to R$75.4 billion because of the decline in car production and fewer exports of spare parts to Argentina.

"The obligation for automakers who want the benefit of reduced IPI tax [through the Innovate-Auto program] to buy parts in Brazil can bring good results for our companies," Butori said. He said government tracking of auto parts will make it possible to verify whether parts are actually bought from domestic suppliers, who now also have a more favorable exchange rate.

Buroti said the auto parts sector "innovates little because the costs are high." To ensure sector growth without bumps, "we need a realistic industrial policy that takes into account all the effects that external and domestic markets have on the auto industry as well as investments in technology and machine modernization ... That's what happened in Japan, which China and India are copying."

New model for investing in public education

Solange Monteiro

IN THE LAST TWO DECADES, BRAZILIANS have become more educated. Investments in education grew, and average years of schooling for youths aged 18 and 24 went up 55% in the nine years to 2012. Unfortunately, the quality of education did not improve at the same rate. According to the latest report of the Programme for International Student Assessment (Pisa), among 65 countries Brazil ranked 55th in reading, 58th in math, and 59th in science.

Not using resources efficiently to improve the quality of education is a serious concern at a time when investment in public education is expected to surge. One of the 20 goals of the National Education Plan (PNE) approved in 2014 is to double investments in education to 10% of GDP in the next 10 years. The main source of the necessary funds will be revenues from deep sea oil consisting of 75% of oil royalties and 50% of the Deep Sea Oil Social Fund. "It is evident that improving the management of education in Brazil is important so that those resources are directed to initiatives that have the most potential to improve learning," says IBRE researcher Fernando Veloso. For that reason in early December the Brazilian Institute of Economics (IBRE) of the Getulio Vargas Foundation held a seminar in Rio de Janeiro on "Finance and Management of Education in Brazil."

Public spending per student

Veloso, one of the seminar organizers, reminded the audience that from 2000 to 2011 public spending per student went up two and a half times, according to official data (adjusted for inflation) from the National Institute of Educational Studies Anísio Teixeira (INEP). During this time public spending per student was concentrated on basic education, reducing its investment gap with higher education. "In 2000, investment in higher education was 11 times the amount invested in basic education; today, it is 5 times. Compared to the average of Organization for Economic Co-operation and Development countries, which is less than double what goes into basic education, the investment gap is still high, but we have managed to reduce it significantly," Veloso says.

Veloso also points out that in addition to the resources specified in the PNE, demographic changes will help increase investment per student. Veloso and fellow IBRE researcher Fernando de Holanda Barbosa Filho, estimate that as the group aged 6 to 14 declines as a percentage of the population, investment per student in basic education should double in real terms by 2030 and be 3.5 times higher by 2050. But Veloso warns, "We will have more resources for education in coming decades, but so far there is no guarantee that the quality of education will improve."

Certainly, there is no evidence that oil royalty resources by themselves have improved Brazilian education. Joana Monteiro, also an IBRE researcher, compared the performance of municipal public education of 60 oil-producing municipalities, which received oil royalties, and non-producing oil municipalities from 2000 to 2010. "The oil-producing municipalities spent

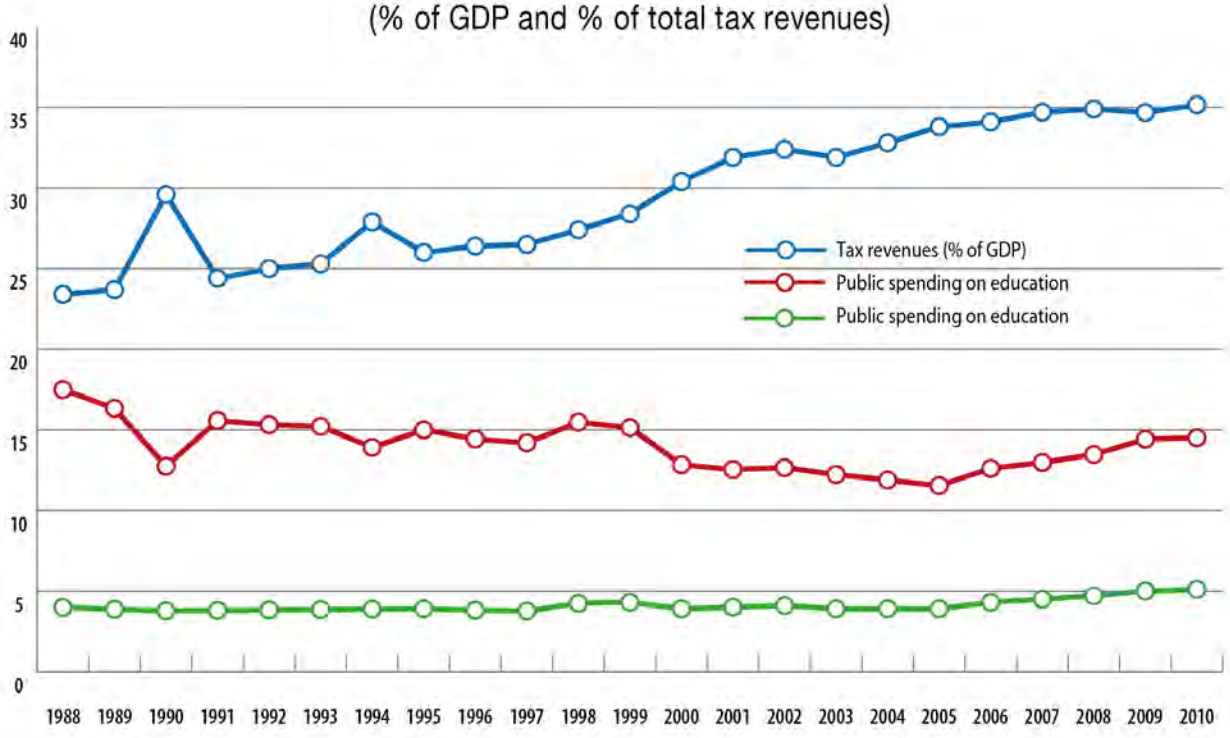
R$72 per capita more on education between 2000 and 2010," she says, which implies an 11% increase in spending on education. Yet there was no significant improvement in education. In 2010, on the Brazil Test (national assessment exam for 5th and 9th graders) the oil-producing municipalities had the same number of students in basic education, a larger percentage of children behind in school, and no significant difference in grades in math and reading than non-producing oil municipalities. Monteiro concludes that "The increased spending did not reach the students." She suggests that among the main reasons were misuse of resources, money wasted on ineffective measures, and spending in goods and activities that do not affect learning.

Another study by the School of Economics and Administration, University of São Paulo confirms the current waste of resources in management of public education in Brazil. "One of the most common irregularities is inefficiency in the use of resources, predominantly due to corruption," says Fabiana Rocha, study co-author. The study concluded that smaller municipalities (up to 50,000 inhabitants) are less efficient and could cut their spending by almost 50% and still achieve the same Basic Education Development Index (Ideb)

According to the latest report of the Programme for International Student Assessment (Pisa), among 65 countries Brazil ranked 55th in reading, 58th in math, and 59th in science.

Brazil: Public spending on education

(% of GDP and % of total tax revenues)



Sources: Brazilian Institute of Economics (IBRE); Brazilian Institue of Geography and Statistics (IBGE), National Accounts (2012); and Maduro Jr. and Paulo Roberto Rodrigues (2007); and National Institute of Educational Studies Anísio Teixeira (INEP, 2013).

As the group aged 6 to 14 declines as a percentage of the population, investment per student in basic education should double in real terms by 2030 and be 3.5 times higher by 2050.

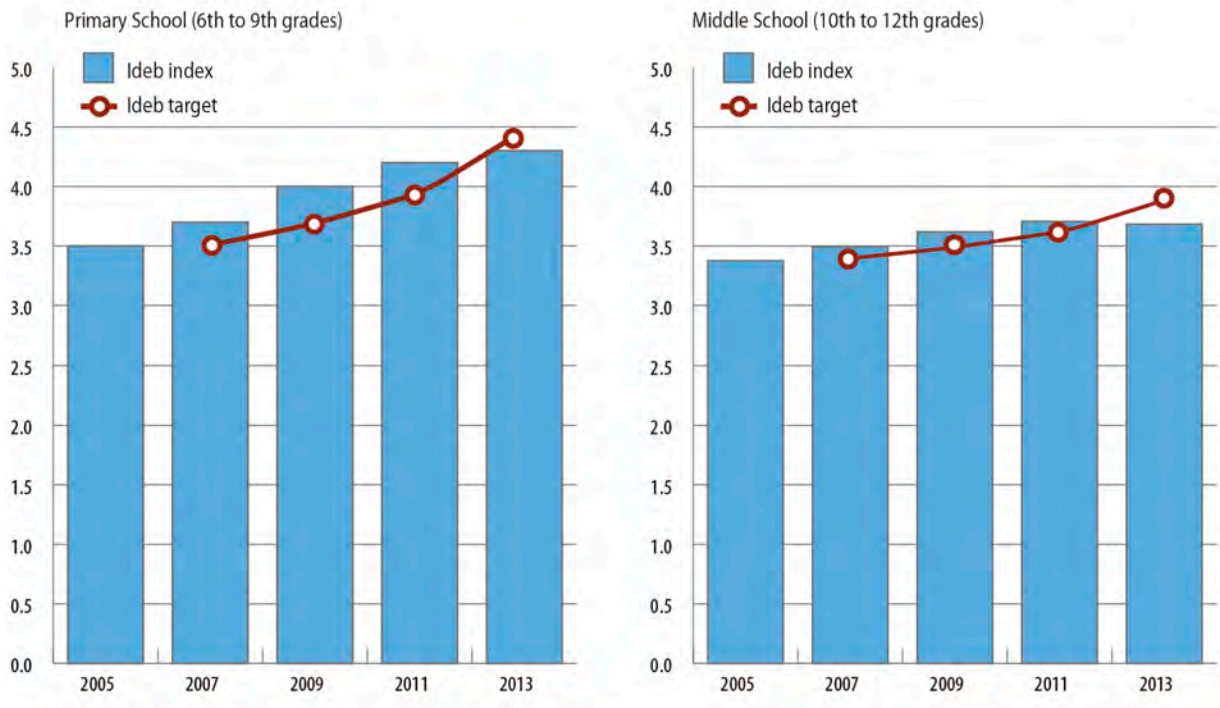
target set by the federal government. Major cities (over 500,000 inhabitants) could cut spending by almost 20%. "Every year smaller municipalities are wasting R$12 billion. Clearly it is necessary to make efficiency in public spending a policy priority," she says. Paulo Moura, who followed up approval of the PNE as a consultant to the Chamber of Deputies concurred in the need for cost efficiency.

It is also necessary to educate 2.9 million young people aged 4 to 17 who are still outside the education system. Barjas Negri, president of the Foundation for the Development of Education of the State of São Paulo, points out that this is a major challenge especially for high schools, noting that "We have 1.5 million young people aged 14 to 17 who are not in school."

How to manage better

To translate resources into better learning is not simple. Fernando Abrúcio, School of Business of São Paulo, studied state departments of education and found out that, although management and governance is a growing concern, there are huge variances across the country. "There are cases of departments that had four directors in a four-year period; it's hard to have good management with such high turnover of managers," he says. He also cites the difficulties regional directors

Brazil: Evolution of the Basic Education Development Index (Ideb)



Source: National Institute of Educational Studies Anísio Teixeira (INEP).

and coordinators have in evaluating school performance, and the difficulties states and municipalities have in coordinating their policies. To mitigate these problems, there has been growing support from private institutions. One is the Unibanco Institute, which since 2008 has promoted the Youth with a Future program. "Our goal is to train supervisors and directors on improving their management skills, discussing their problems and uniting them around the same goal," says Mirela Carvalho, Unibanco Institute manager of knowledge management. "By 2018, our goal is to benefit 2 million students."

The good news is that the public school system is already working to identify best practices. In recent years, school systems in Ceará and Rio de Janeiro states have overcome poverty, structural deficiencies, and cultural resistance in order to significantly improve management of education and student achievement. Mauricio Holanda, Ceará secretary of education, points out that one of the first steps is to design a business model that involves principals and teachers and creates a system for technical cooperation between schools so that the results do not depend on a single person. Ernesto Martins de Faria, project coordinator of the Lemann Foundation, who has analyzed good performance of schools in poor regions of Goiás, Tocantins, Ceará, Paraná, and Rio de Janeiro states, says in terms of good practices, "What we saw in common is close and continuous monitoring of learning, working with data to support pedagogical choices, and making school a nice and constructive learning environment."

"We will have more resources for education in coming decades, but so far there is no guarantee that the quality of education will improve."

Fernando Veloso

In all these cases, the policies adopted pointed to the same conclusion: poverty does not doom students to hopeless school performance. "In the municipality of Sobral, 25% of the population lives in poverty, 10 percentage points more than the country's average, yet the Ideb index of the municipal school system in the elementary school is 7.8 compared with 5.2 at the national level," Holanda says. Wilson Risolia, former Rio de Janeiro state education secretary, says that the shortcomings of education are well known; what is needed now is faster action. He adds, "We have a country with huge potential, but with education that incompatible with that potential."

Brazil: Evolution of public spending per student

(in Brazilian reais)

	Basic Education (1st to 9th grades)	Primary Schools (1st to 4th grades)	High School (10th to 12th grades)	College
2000	1,633	1,606	1,557	18,050
2004	2,147	1,928	1,333	15,001
2008	3,524	3,248	2,497	17,370
2011	4,916	4,341	4,212	20,690

Source: IBRE.



Photo: Cris Torres.

Mauricio Holanda, education secretary of Ceará state

"A rare experience of bottom to top policy-making"

Reform of public education management in Ceará state started in the early 2000s in the municipality of Sobral, population 190,000. At that time, 60% of Sobral children reached the third grade without knowing how to read and 20% were still not able to read in fifth grade. Today, Sobral, where GDP per capita is just over half the Brazilian average, has a zero dropout rate in elementary education, compared with a 10% average for Brazil as a whole; only 4 percent of students are not in the age-appropriate learning grade, compared with 24 percent for the country; and the Basic Education Development Index (Ideb) is 7.8 for the early years of elementary education, compared with the national average of 5.2.

"We learned to create a system of rules, incentives, and group learning. We did a broad-based intervention, and adopted a simple external evaluation to reward and hold teachers and schools accountable," says Mauricio Holanda, state education secretary. Holanda believes the results of this reform undermined the common argument that many students do not learn because they are poor or have other special difficulties. "We showed that the number of children who would not be able to learn reading without reinforcement, or without an environment with accommodations, is not 30% but 3%," he says.

From the example of Sobral other municipalities in Ceará sought cooperation in reforming school management. In 2007 the state education department extended Sobral's experience by setting up the Literacy Program at the Appropriate Age (PAIC). This in turn inspired the National Literacy Program at the Appropriate Age. "This is one of the rare experiences of policy-making from bottom to top," says Holanda, a committed advocate for municipal education. One important measure was to increase financing for education by changing the law that defines the transfer of the value-added tax on goods and services (ICMS) to municipalities. "We have instituted more meritocratic criteria and focused on education. Of the 25% of the state VAT tax that can be distributed at the discretion of state law, 18% is conditional on meeting performance targets in elementary education, health, and the environment," he says. After changing how resources are allocated, some smaller municipalities recorded revenue growth exceeding 60%, and Ideb index differences between municipalities declined.

Holanda also highlights another aspect of the program: schools whose performance is good provide technical cooperation to schools where performance is poor. "This is part of a set of measures that makes possible good performance independent of individuals. Even in Sobral, though there was a four-year period in which the city had three directors of education, the education plan did not change. We must invest in training competent teams, so they do not become dependent on only one person," he says.

He does have concerns about the national program inspired by the PAIC, however. "The Federal Government's policy is one size for all, which causes difficulties," he says. "For example, the percentage of 8-year-old children who cannot read and write in Santa Catarina state is 5% and in Alagoas state it is 34%. If you offer the same benefits and incentives for teachers, in Santa Catarina it will not be very effective, but in Alagoas it will be very important … The federal government is very controlling in terms of policy and loose in terms of monitoring results; it should be the other way around, " he says. That reality will now be in the hands of the new federal Minister of Education, Cid Gomes, who was mayor of Sobral and governor of Ceará during the state's education transformation.



Photo: Cris Torres.

Wilson Risolia, former education secretary of Rio de Janeiro state

"If we continue just discussing, we will lose another generation"

In the release of the Basic Education Development Index (Ideb) for 2013, Rio de Janeiro state confirmed the recovery of its public schools. In 2009, the state had ranked 26th, then 15th in 2011, and reached 4th place in 2013. Its school drop-out rate also fell, from 16.5% of students in 2009 to 7.3%. "Of the 1,457 state schools, 73% were classified between regular and bad in 2013. We were not able to fix all schools, but we have advanced a lot," says Wilson Risolia, who after a long career in capital markets was state education secretary for four years, ending in 2014.

To improve school infrastructure and management, Risolia had to face down resistance from a variety of vested interests. "There is a strong ideological bias against external evaluation of teaching and the minimum curriculum; it is argued that evaluation takes away teachers' pedagogical freedom. However, the fact was that the children were unable to read," he says. "In the four years I was education secretary, I was never called on to discuss why children could not read, but I was summoned several times in public hearings to justify why I changed school principals, whose appointment is dominated by political feuds. In the public sector, 'meritocracy' was also a dirty word, but it was a non-negotiable value for us."

According to Risolia, one aspect of the education strategy was to improve the quality of public spending. "Putting more money in inefficient areas is wasting money. In three years, we cut waste by R$100 million, and were then able to raise teachers' salaries, improve school infrastructure, and create benefits and awards for students," he says. To support creation of a new policy for the sector, the Education Department carried out a survey which showed, for example, that only 20% of schools with the worst education scores were in poor areas, and 73% of the parents of students had not completed basic education, which could mean they were not able to encourage studying. The important finding for reforming high schools was that students said they liked school, but they dropped out because they considered that school added little to their lives. He says that "As we discuss the problem endlessly, we are losing young people, and the demographic window is closing. If we continue just discussing it, we will lose another generation."

To circumvent this impasse, the state Department of Education decided to boost the Dual School program, which adds vocational education to the core curriculum. The initiative was born in 2008 in partnership with the Oi Futuro Institute. Training areas include bakery, hospitality, information technology, and agriculture. The vocational training is provided by partnerships between schools and such companies as Pão de Açúcar, ThyssenKrupp, Embratel, Institute Ayrton Senna, and the Federation of Industries of Rio de Janeiro. "Our average cost per public school student is R$4,061. A Double School is just over R$5,000, and companies finance the technical training," says Risolia. "This is a worthwhile marginal cost, especially considering that 60% of students were two years behind in their schooling and when a student repeats one school year it means we waste R$8,000, if schools reduce repetition and we train students for the labor market, we will make a profit. What is costly for society is to leave things as they are."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