Labor Market
Fewer jobs, less income ahead

Fiscal Policy
A recessive adjustment

Interview
Paulo Stark
CEO of Siemens Brazil



THE BRAZILIAN ECONOMY

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Lower commodities prices depress recovery

The end of the commodities price boom will not only bring down Brazil's exports, it will affect funding for social programs.

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THE BRAZILIAN ECONOMY

Economy, politics, and policy issues

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THE BRAZILIAN ECONOMY

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Photo: Valter Campanato



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Cover Story

Lower commodities prices depress recovery



8 The depressing international outlook and Brazil's misguided policies for making its industry more competitive are likely to prevent a vigorous recovery of the country's exports in 2015, after a fall of 7% in 2014. And commodities make up a disproportionate share of Brazil's exports. Chico Santos reports on international variables that are making commodities exports particularly vulnerable today.

The commodities boom: A wasted windfall

16 Sustaining social achievements now that the commodity export boom has ended will depend on how each country used its commodities windfall. Brazil did not do a good job and must now deal with exchange rate depreciation and slowing growth in China, a major trading partner. Solange Monteiro analyzes the situation.

Labor Market

Fewer jobs, less income ahead

18 In January, unemployment jumped to 5.3%. and In 2015 the slowing economy and rising inflation are likely to cause further deterioration of the labor market, with wages stagnating and jobs disappearing. In recent years, Brazil's unit labor cost has been rising faster than inflation. Cristina Alves asks the experts what Brazil can do to turn things around.

Immigration Policy

How to make Brazil more receptive to immigrant workers

22 In recent years fewer Brazilians have been working abroad, and more foreigners have entered Brazil's labor market. But Brazil still has shortages of both high-and low-skilled workers, which could jeopardize future GDP growth. People coming in to fill the jobs are strangling in red tape. Solange Monteiro reports.

Credit

How well did state-owned banks expand access to financing?

26 Larger and less risky companies benefited most from subsidized credit, a report analyzing a million companies that borrowed R$30,000 or more between 2004 and 2011 has found. Thus, Solange Monteiro reports, the main effect of increased public credit was to shift demand from private to public financing, at considerable cost to the Treasury.

Fiscal Policy

A recessive adjustment

28 Professor Marcos Cintra explains why the fiscal adjustment in Brazil may make the tax burden much heavier by increasing tax rates, creating new taxes, and eliminating exemptions. For a more effective and expeditious adjustment, he recommends that Brazil adopt zero-based budgeting to eliminate ineffective programs that survive merely by inertia.

Interview

What Brazil needs to really grow



31 Paulo Stark, CEO of Siemens Brazil, talks with Solange Monteiro about how resumption of growth in the US and the EU looks promising for Brazil and suggests this would be a good time for businesses and the government to rethink their investments. He is concerned, however, about Brazil's lack of productivity and about problems it may have in attracting private investment.

From the Editors

BRAZIL'S BUOYANT LABOR MARKET ended 2014 with a December unemployment rate of 4.3%, the lowest since 2002. As the Brazilian economy undergoes a long-needed adjustment, the consensus is that this rosy picture will not last. Signs that the once-booming employment market is losing steam have begun to show up. Brazilian companies laid off workers in January at the fastest pace in six years. Factories, farms, and service companies cut 81,774 jobs in January, at which point the unemployment rate jumped to 5.3%. Unemployment this January compared unfavorably with the 4.8% that it registered in January 2014.

In addition to a slack labor market, wage increases are likely to slow down significantly, which means that consumers are likely to become more pessimistic. The February FGV Consumer Confidence Index was 4.9% lower than in January, reaching its lowest level since September 2005.

Continuing economic adjustment is also needed to address Brazil's large external current account deficit. Among other benefits, the favorable winds that blew on Brazil and other Latin American countries during the commodity price boom helped to keep employment low and reduce income inequality, but those winds have since died down. That the commodities boom has turned to bust is now quite evident and social programs may have to be cut if alternative ways to finance them are not found fairly quickly. Unfortunately, unlike China, Brazil did not take advantage of the commodities windfall to improve stagnant Brazilian labor productivity. As Armando Castelar points out in this issue, now that commodities prices have plunged, income growth for Brazilians will depend primarily on higher productivity and more investment.

Another problem addressed in this issue is the realization that the larger share of state-owned banks in the credit market today has not necessarily meant more credit for companies that find it harder to access finance —such as innovative, riskier, and smaller companies. But the loans of state-owned banks to larger corporations have done nothing to increase fixed investment. Despite the massive National Development Bank loans over the last four years, IBRE staff estimate that fixed investment actually declined, from 19.3% of GDP in 2011 to 16.9% in 2014.



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ECONOMY

Truck driver roadblocks affect exports

In late February truck drivers blocked roads in several Brazilian states in protest against the high cost of fuel and tolls, slowing deliveries of soya and corn to one of Brazil's main ports, Paranaguá. Police fired tear gas and arrested seven people, but failed to open up access to the port. (February 24) On March 2, President Dilma Rousseff signed a new trucking law that defines working hours and training for drivers and mandates accident insurance, health care, and rest time. It also forgives fines for overweight issued in the last two years. The following day a key highway in top soy producer Mato Grosso state opened after two weeks of blockage, and roadblocks on federal highways were down from 100 to just 7. (March 3)



Photo: Valter Campanato/Agencia Brasil.

Truckers concentrated in the vicinity of Brazil's capital, Brasilia, awaiting negotiations with the government.

Junk rating for Petrobras debt

Moody's downgraded Petrobras by two notches to below investment grade and has adopted a negative outlook. The changes stem from concern about corruption investigations and liquidity pressures, as well as Moody's expectation that the company will find it difficult to reduce its high debt burden meaningfully for several years. (February 25)

Industry and consumer confidence worsen

Brazil's main consumer-confidence index fell by 4.4% to 85.4 points in February, the Getulio Vargas Foundation said. This is the lowest confidence level since September 2005. The lack of confidence was attributed to pessimism over a sputtering economy, inflationary pressures, and rising interest rates. (February 25) The Industrial Confidence Index declined by 3.4% in January to 83, FGV said, and is extremely low by historical standards. Industry has recorded zero growth for six quarters. (February 27)

January was bad news for workers

The unemployment rate rose more than expected in January, reaching 5.3% in January, its highest level since September 2013, government statistics agency IBGE said. (February 26) Brazilian companies also shed jobs in January at the fastest pace for the month in six years. Factories, farms, and service companies in Brazil cut 81,774 jobs in January, the Ministry of Labor said. (February 27)

Inflation nears 10-year high

The consumer-price index rose 1.22% in February after going up 1.24% in January, government statistics agency IBGE said. Cumulative 12-month inflation through February was up 7.70%, the highest it has been in nearly 10 years and far beyond the central bank's 6.5% inflation-target ceiling. Inflation in February was fueled by higher bus fares in some cities and high gasoline prices nationally. (March 6)

TRADE

Brazil and Mexico renew auto quotas

Yielding to Brazilian pressure, Mexico's Economy Minister Bruno Ferrari said that Mexico had agreed to curb its auto exports to Brazil to an average of about US$1.55 billion a year over the next three years. The dispute has laid bare the differences between free-trade disciple Mexico and increasingly protectionist Brazil. Analysts said a quota on Mexican exports will not solve the issues that are making Brazilian automakers less competitive. Brazil's auto industry lost seventh place among the world's largest auto makers to Mexico in 2014. (March 15)

ECONOMIC POLICY

Head of BNDES Reappointed



Photo: Marcelo Camargo/Agencia Brasil.

Luciano Coutinho, head of BNDES, favors government-led growth.

President Rousseff reappointed Luciano Coutinho as head of the National Development Bank (BNDES). Coutinho, who has held the post since 2007, led the bank expansion of long-term loans in an effort to fuel economic growth. However, it mainly benefited large companies who took advantage of lower interest rates. Finance Minister Joaquim Levy has vowed to scale back public funding for BNDES and to continue to raise interest rates on BNDES loans. (February 20)

Spending capped through April

The Brazilian federal government has announced that through April it will limit federal spending and cap certain investments at R$75 billion (US$26 billion). In the same period in 2014, such spending was about R$85 billion. The measure is seen as another sign new Finance Minister Joaquim Levy and Planning and Budget Minister Nelson Barbosa are serious about getting public finances in order. (February 27)

Brazil records 21.1 billion reais January primary surplus

Brazil's public sector recorded a fiscal primary surplus of R$21.1 billion (US$7.3 billion) in January, the central bank said. December showed a primary deficit of R$12.9 billion—Brazil's first primary deficit since 2002. The 2015 target is a primary surplus of 1.2% of GDP. The primary result includes all government revenue minus all spending, except debt-interest payments. (February 2015)

President, Finance Minister disagree

Finance Minister Joaquim Levy has announced a rollback of the tax breaks on payrolls and export revenue that were at the heart of industrial policy in the president's first term, because they "didn't yield the expected results and turned out to be extremely expensive." (February 27) A day after Levy said that the payroll tax relief was a "gross mistake" President Dilma Rousseff said that his statement was "unfortunate" and that payroll tax relief is "important and remains." According to Levy, that tax cost Brazil R$25 billion. (February 28)



Photo: Valter Campanato/Agencia Brasil.

Finance Minister Joaquim Levy talks about the reduction of the payroll tax relief.

POLITICS

Congress forces Rousseff to negotiate fiscal adjustment

Pressed by political difficulties, pending investigation of the Petrobras corruption scandal, and an economy in trouble, President Rousseff has opened a personal dialogue with the President of the House, Eduardo Cunha (PMDB-RJ). The rapprochement to Cunha signals that the president wants to find common ground with the largest party supporting her administration. (February 23)

Congress rebelling over austerity measures

President Dilma Rousseff recently met with legislative leaders from her coalition after they unexpectedly threw out a presidential decree that would have raised payroll taxes and helped close a gaping hole in Brazil's budget. The Congressional action threatens Rousseff's adjustment policy and could worsen an expected recession this year.

Senate President Renan Calheiros threw out the austerity decree for what he called procedural reasons. Hours later, Brazil's top prosecutor asked the Supreme Court to open investigations into 54 people, most of whom are politicians accused of benefiting from a multibillion-dollar kickback scheme at Petrobras. Citing unnamed Calheiros allies, *Folha de S. Paulo* newspaper said that his opposition to the decree was a pressure tactic designed to show the government his displeasure at being on the list. (March 4)

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Lower commodities prices depress recovery

The end of the commodities price boom will not only bring down Brazil's exports, it will affect funding for social programs.

Chico Santos

THE DEPRESSING INTERNATIONAL OUTLOOK, in which the only bright spot is the recovery of the US economy, and Brazil's misguided policies for making its industry more competitive are likely to prevent a vigorous recovery of the country's exports in 2015, after a fall of 7% in 2014.

The collapse of commodity prices that started last year because of weak global demand will once again make it another bad year for Brazilian exports. The Center for Foreign Trade Studies (Funcex) forecasts that soy, iron ore, and foreign sales of crude oil will be down US$14.6 billion in 2015. Soy exports will fall by 26%, from US$30.3 last year to US$22.4 billion; iron sales will drop by 10%, from US$25.8 billion to US$23 billion; and crude oil exports will fall from US16.4 billion to US$12.5 billion.

"These three products will cause serious problems for the Brazilian trade balance this year," said Funcex economist Daiane Santos, because they represent a large share of total exports. For example, the share of iron ore, soybeans, and soybean meal in total exports shot up from 14% in 2009 to 49.3% in 2012–14.

The concentration of Brazilian exports in commodities is even more evident when we compare the top 10 products exported over time. In 2000–02, the top 10 consisted of 4 basic commodities, 4 manufactured goods (airplanes, automobiles, transmission and reception equipment, and footwear), and 2 intermediate goods (pulp and steel). In 2012–2014, there are no manufactured goods, only 2 intermediate goods (pulp and raw sugar), and the rest were all commodities.

According to Funcex, if only 10 products now account for almost half of Brazilian exports, and almost all of them are commodities, it is obvious that our export revenue is highly volatile because it is highly dependent on changes in international prices for agricultural raw materials, minerals, and energy.

Brazil's misguided policies for making its industry more competitive are likely to prevent a vigorous recovery of the country's exports in 2015.

Outlook not promising

Despite low commodities prices, Funcex estimates that devaluation of the exchange rate will mainly dampen imports and bring about a trade surplus this year, after a US$3.9 billion deficit in 2014—the first since 2000.

Funcex is projecting a trade surplus of US$3.6 billion for 2015 as imports are expected to fall by 11%, to US$203.1 billion, which would more than offset the predicted drop of 7.8% in exports, to US$207.5 billion.

Funcex's Santos, believes that coffee, beef,



International outlook
The fall in crude oil price will affect Brazil's export revenues.

Export revenue is highly volatile because it is highly dependent on changes in international prices for agricultural raw materials, minerals, and energy.

cellulose, and corn will perform relatively well, and manufactured goods exports may grow a somewhat optimistic 6% as the US economy recovers. However, exports of manufactured goods will not contribute much to better the trade balance because economic activity in Argentina, one of the largest importers of Brazil's manufactures, is turning downward.

The Foreign Trade Association of Brazil (AEB) is a little more optimistic. The organization's president, José Augusto de Castro, said that "for now" AEB is forecasting a surplus of US$8.2 billion this year, based on US$215.4 billion in exports and US$207.2 billion in imports. Castro points out, however, that the forecast may change significantly because "the outlook is changing a lot."

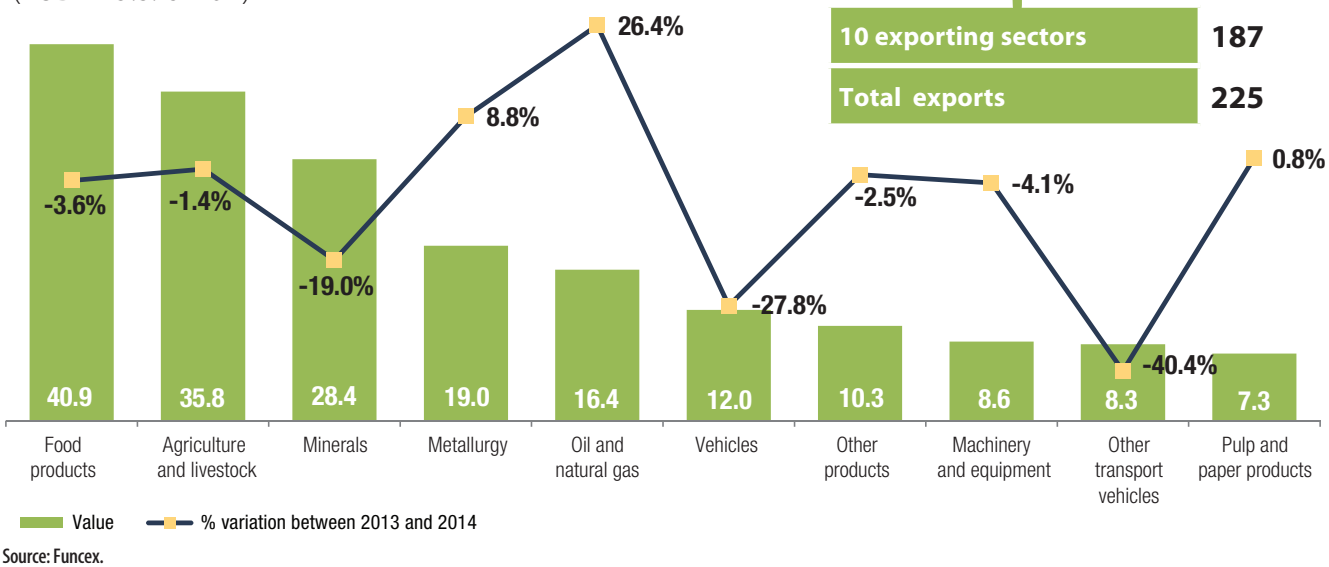
A surprise for Castro was the huge growth in crude oil exports early this year. "In February 2014 we exported a daily average of 65,000 metric tons per day. In the first three weeks of this year, we exported 173,000 metric tons per day, more than double." He estimates an increase in crude oil exports of 17% in 2015.

Castro agrees with Funcex that Brazil's export performance will be determined by the plunge in the prices of soybeans, oil, and iron ore. "The iron ore picture is scary," he says, noting that the price fell from US$75 a metric ton in January 2014 to US$49.8 in the third week of February.

In its 2014 Financial Report, Vale mining

10 sectors account for 80% of total Brazilian exports.

(FOB in U.S. billion)



Source: Funcex.

company, one of the world's largest exporters of iron ore, said that "despite the strengthening of the U.S. economy, the market for iron ore and pellets was negatively impacted by the weakness of economic activity in Europe and Japan and the slowdown in the Chinese economy, which grew 7.4% in 2014." According to Vale, although Chinese growth is still significant, the credit slowdown in China impacted sectors driven by investment, especially real estate. With the general downturn of the global market, the price of iron ore fell 47% last year.

For another important Brazilian commodity export, sugar, Castro expects a fall in price this year, but a small one. Last year, Brazil's exports of sugar and alcohol fell by 24% to US$10 billion. According to the Union of the Sugar Cane Industry, in 2014 the international price declined by 6.4% to 16.35 U.S. cents a pound.

Despite low commodities prices, Funcex estimates that devaluation of the exchange rate will mainly dampen imports and bring about a trade surplus this year, after a US$3.9 billion deficit in 2014—the first since 2000.

Castro does not expect much increase in manufactured goods exports this year, especially since falling commodity prices will

Since 2011, prices of commodities exported by Brazil have declined, while the volume of commodities exported stagnated.

(Price and volume indexes, year 2002=100)



Source: IBRE.

Exports of manufactured goods will not contribute much to better the trade balance because economic activity in Argentina, one of the largest importers of Brazil's manufactures, is turning downward.

cause most countries in Latin America, the main market for Brazilian manufactures, to import less. He said, "Since 2008, manufactured goods exports have not grown by one dollar. This year they would need to grow at least 10% [to make up for losses in commodities exports]. That is unlikely."



Right foot
With the devaluation of the exchange rate and the downturn of the domestic economy reducing labor costs, labor-intensive sectors will gain some competitiveness in the international market.

Castro believes that exports of labor-intensive manufactured goods like footwear and clothing can increase. With the devaluation of the exchange rate and the downturn of the domestic economy reducing labor costs, labor-intensive sectors will gain some competitiveness in the international market. He also hopes to see sales of manufactured goods to the U.S. rise.

China weight

IBRE researchers Lia Valls Pereira and André Luiz Silva de Souza argue that, despite low commodity prices, the export outlook would not be so dismaying were it not for the weight of China in Brazil's exports. Pereira points out that the IBRE commodities price index (which covers 23 Brazilian export commodities) fell 18.7% between 2011 and 2014, but was still higher than the 2008 index just before the international crisis broke out. At the same time, the IBRE commodity volume index grew only 5.2% between 2011 and 2014—not enough to offset the fall in commodities prices. By 2011 Brazil's commodities exports had become overly dependent on Chinese demand; that is no longer the case today.

Currently, Pereira sees no way to replace Chinese demand in the short term. "I think India [another great

buyer of commodities] does not have that power," she adds. However, she believes that if Europe and Japan, two other big markets for Brazil, resume growth, Brazil might be able to compete with the U.S., which also exports commodities to these markets.

Many variables are at play in a very volatile global commodities market. Pereira notes, for example, that China has been investing heavily in production of commodities in African countries, and it will take time to see how these investments will affect the global market. In Brazil, beef prices rose because of more buying by Russia after it was barred from buying in other markets in retaliation for its participation in the conflict in Ukraine. With the fall in oil prices, its main export, Russia has reduced its purchases of Brazilian beef, so beef prices are again falling.

Yet despite all the uncertainties, Pereira expects the Brazilian external current account deficit to fall in 2015 by 17.5%, to US$75 billion, down from US$91 billion in 2014. She believes that the devalued exchange rate will reduce the international travel deficit to US$10 billion, down from US$18.6 billion in 2014, and raise the trade surplus by US$3 billion.

"Since 2008, manufactured goods exports have not grown by one dollar. This year they would need to grow at least 10% [to make up for losses in commodities exports]. That is unlikely."

José Augusto de Castro

Hope from the external sector?

"Any basic economics manual says that when the domestic market is in bad shape, attention must focus on exports, to make the country become stronger and change the



World locomotive
Brazil has to find alternative export markets to replace the declining demand from China (photo).

> **"Any basic economics manual says that when the domestic market is in bad shape, attention must focus on exports, to make the country become stronger and change the credit risk perception."**
>
> *Fábio Silveira*

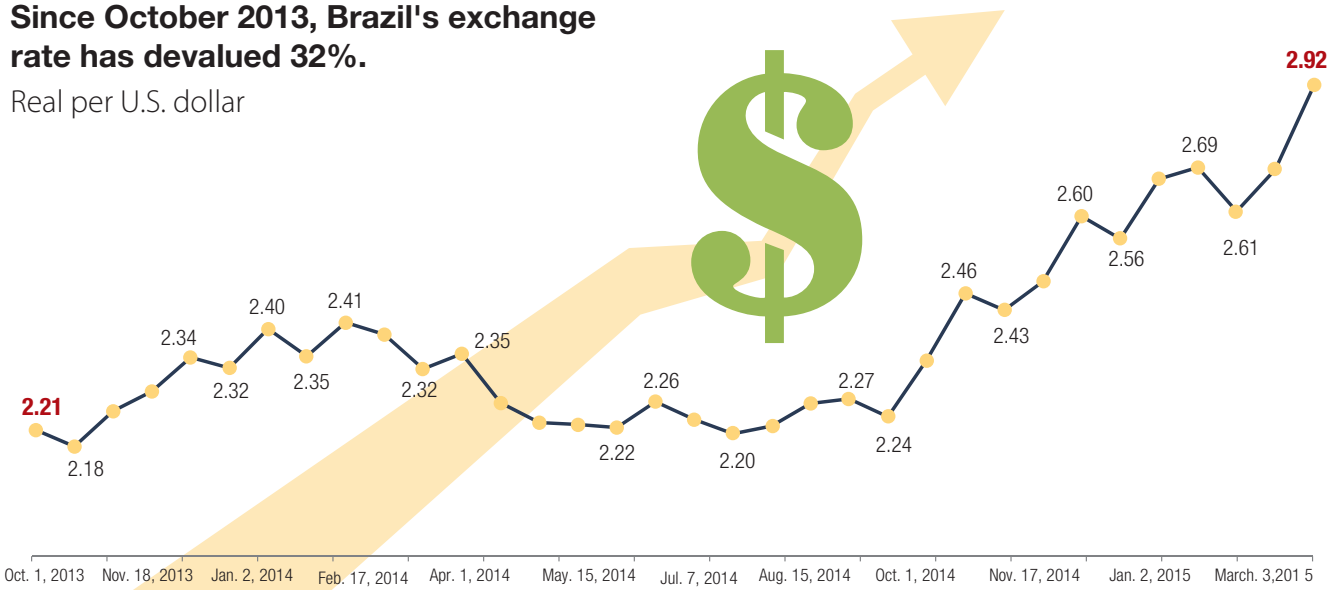
credit risk perception," says economist Fábio Silveira, research director of Go Associates, an economics consultancy. He believes that in the short and medium term commodities will not help Brazil, and argues that to overcome Brazil's current difficulties, in addition to an exchange rate more favorable to exports, industry needs to regain competitiveness.

Silveira foresees a small trade surplus of US$2 billion this year, but he warns that, given the current global outlook, "By no means will Brazil post the robust sales of years ago. We lost competitiveness, China's demand slowed, and we will have to deal with the lower commodities prices." Although he believes the U.S. will be the growth locomotive of the global economy, it is not a big buyer of commodities.

Silveira sees an average exchange rate of R$2.80 per US$1 for 2015 as the main factor that can help raise competitiveness in some industries, especially those that are labor-intensive, since the domestic downturn will reduce wage increases. He also sees promise in products with high added value, such as vehicles, despite the crisis in Argentina, Brazil's largest vehicle market.

Since October 2013, Brazil's exchange rate has devalued 32%.

Real per U.S. dollar



Source: IBRE.

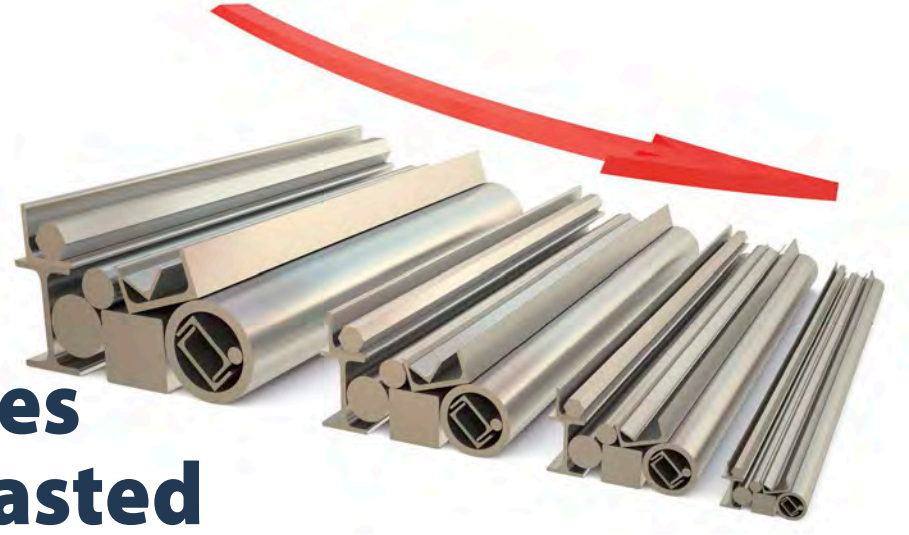
Silveira believes that Latin American economies like Chile, Colombia, and Peru, will benefit from the U.S. recovery and will be able to take in part of Brazilian vehicles that would otherwise go to Argentina. He also underscores that the United States itself is a potential market for Brazilian manufactured goods. "Too bad we disregarded industry for so long; otherwise we would take better advantage of the current U.S. recovery," he says.

China has been investing heavily in production of commodities in African countries, and it will take time to see how these investments will affect the global market.

Some see a gleam of light for some exports. Andreia Adami, researcher at the Center for Advanced Studies in Applied Economics, University of São Paulo, estimates that the recent devaluations of the exchange rate, which should continue throughout 2015, could increase export revenues from agricultural products because exporters would earn higher revenues in local currency. Adami also points out that some commodities, like sugar, could benefit from a recovery in international prices as a result of a better balance between supply and demand. Coffee, meat, and orange juice could also benefit from higher international prices.



No prospects
Brazilian manufacturing export outlook could be negatively affected by political and economic uncertainties in Argentina and Venezuela (photo).



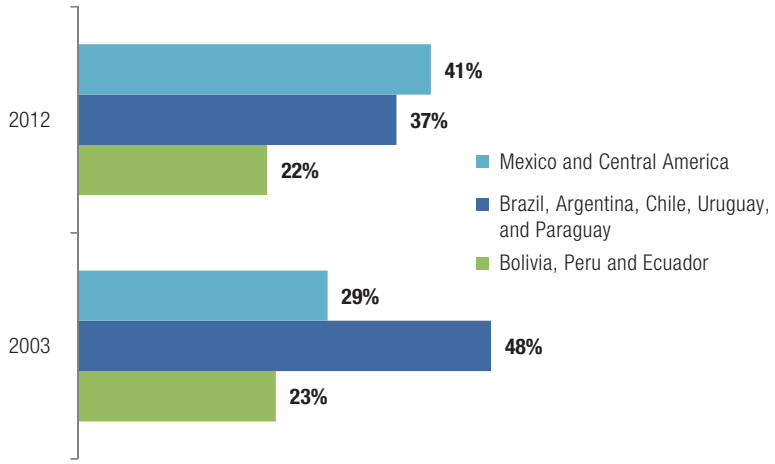
The commodities boom: A wasted windfall

Solange Monteiro

THE END OF HIGH COMMODITIES prices not only affects Brazil's economic growth but also threatens the social gains made in the last decade. Armando Castelar, IBRE coordinator of applied economics, points out that the commodities boom made a major contribution to reducing inequality in Brazil: it helped to raise tax revenues enough to carry out income transfer and social security policies and led to exchange rate appreciation, which although a detriment to exporters benefitted most sectors not related with foreign trade. The appreciation especially benefited the labor-intensive service sector, creating more jobs and pushing up wages. "During this period," Castelar explains, "it was possible to stimulate domestic demand and the resulting imports because the large volume of commodities exports minimized the impact on inflation and the external trade balance. From 2004 to 2011, Brazilian growth was concentrated in such sectors as construction, commerce, and financial intermediation, which employed a large number of unskilled workers."

With the end of the commodities boom, the situation has been reversed. To balance the external current balance deficit, it will be necessary to devalue the exchange rate, which implies a less favorable environment for service sectors to hire. Castelar points out that "With the end of the commodities windfall, income growth will depend on heightened productivity. If Brazil does nothing to raise productivity, there is no way to prevent the deterioration of social indicators."

The share of population living below the poverty line (less US$4 per day) fell significantly in Latin America in the last decade.



Source: World Bank.

This problem is not unique to Brazil. All Latin American commodities-exporting countries have used the proceeds over the past decade to address poverty and income inequality. World Bank data shows that Brazil, Argentina, Chile, Uruguay, and Paraguay all reduced poverty by 11 percentage points between 2003 and 2012, and Bolivia, Colombia, and Ecuador had a less dramatic but perceptible reduction in poverty. In Mexico and Central America, which are more focused on manufacturing exports, over the same period poverty went up by 12 percentage points. The Gini coefficient, which measures income inequality, has also evolved positively for most commodity-exporting countries. The Gini indicator for Brazil declined from 56.8 in 1990 to 50.1 in 2011 (the lower the number, the lower income inequality), for Chile from 51.8 to 48.5, and for Peru, from 52.7 to 46.9. In all these cases, labor income was a major factor: 70% of poverty reduction in Latin America, according to the World Bank, was due to improvement in wages. A study by Nora Lustig estimates that labor income accounted for 45% of the decrease in inequality, followed by cash transfers (14%) and a demographic increase in the number of people of working age (12%) .

The productivity problem

Sustaining social achievements now that the commodity export boom has ended will depend on how each country used its commodities windfall. "Countries that have low inflation and no external current account deficit will not need to raise interest rates and will fare better," says Castelar, citing the cases of Chile, Colombia, and Peru. Things will be more difficult for Brazil, which has a large current account deficit of 4.2% of GDP. It must deal with both exchange rate depreciation and lower growth in China. Based on the DXY index, which measures how the dollar performs against a basket of currencies, and the likely trajectory of Chinese growth, Castelar estimates that in 2015 prices for Brazilian exports will fall by at least 10%, noting that "This means lower prices for non-tradable goods and services, which will reduce labor income."

"If Brazil does nothing to raise productivity, there is no way to prevent the deterioration of social indicators."

Armando Castelar

The outlook for GDP growth is not encouraging either. For the five-year period 2014–18 the Central Bank is estimating average annual increases of just 1%. "If this projection is confirmed and labor productivity continues on the same path as in recent years, an 0. 6% average, the margin left to expand employment will be only 0.4%–not enough to accommodate the growth of the economically active population, which is currently 1.4% a year," Castelar says. The result, he suggests, could be an annual 1 percentage point increase in the unemployment rate.

Mitigating the decline in income and employment will depend primarily on increasing investment and productivity. Unlike such countries as Chile and the United States, Brazil's productivity has been virtually stagnant. "Even China has reduced poverty by putting more productive people in the labor market, while we did almost nothing [to raise productivity]," Castelar says, mentioning the slow progress in upgrading infrastructure. He argues for a more progressive tax system and more care for quality in public spending as complementary policies to support Brazilian workers' incomes. "We have to make public spending more efficient. Part of the social cash transfers today go to people who are not really poor. That must be corrected," he concludes.



Fewer jobs, less income ahead

Cristina Alves

IN 2014 BRAZIL RECORDED its lowest unemployment rate since 2002, 4.8% monthly, according to the government statistics agency survey in six metropolitan areas. But this deservedly celebrated achievement is now part of the past: no one believes that Brazil is likely to repeat the feat this year, or even next. Instead, the general bet is that unemployment will go up and worker incomes go down. In January, unemployment jumped to 5.3%.

In 2015 the slowing economy and rising inflation will cause further deterioration of the labor market. According to the Ministry of Labor, there was an increase of only 396,900 jobs in 2014—64% fewer than in 2013. In January 2015, the labor market actually lost 81,774 jobs.

The 2014 results were mainly influenced by industry, which cut its work force for the first time since 2002, eliminating 163,800 jobs, and construction, which cut 106,500 jobs. Commerce and services, which account for most Brazilian hiring, did create jobs, but far fewer than in 2013.

After having added 5 million jobs during President Rousseff's first term, the labor market is going through a dramatic downturn. "The outlook for the labor market is bad and is likely to be aggravated by the fiscal adjustment and rising inflation, which creates uncertainty for businesses," says Naércio Menezes Filho, professor at the Institute of Education and Research. He adds that "Wages will stagnate, largely because of a smaller increase in the minimum wage."

To change this situation, Menezes recommends more investment in research and development (R&D) so that companies can take advantage of the devalued exchange rate to export more. But for that to happen, he says, a change of mentality is needed. Menezes argues that the government should no longer protect various industries and instead encourage innovation because only in this way can companies reinvent themselves and become competitive. For example, industry, he says, cannot pass wage increases through to prices; and in most cases, wage increases are not accompanied by more worker productivity, so many industries become less competitive.

Gradual deterioration

With a projected fall of 1% in GDP this year, there is no way to keep the labor market buoyant, says IBRE researcher Rodrigo Leandro de Moura, who explains, "The outlook is one of gradual deterioration in the labor market. Consumer and business confidence is worsening. There are high interest rates, credit restrictions, water crisis, and energy prices hikes.

All this is likely to deepen industry's downturn, which eventually will hit the service sector."

De Moura fears a rush of layoffs, negotiated between employers and employees, so that they can draw unemployment insurance before the government's new rules start in March. The government is raising the requirement from 6 months of formal contract work to 18 months for workers to apply for unemployment insurance. De Moura expects that unemployment will rise to 5.6% in 2015 and 6.5% in 2016, up from 4.8% in 2014. He believes income-discounted inflation will stagnate in 2015, after rising 2.7% in 2014.

What needs to be done to turn around this situation? De Moura believes it would be necessary to have more favorable regulation and improve education to heighten the productivity of workers and capital. He also supports more flexible labor laws to reduce turnover. The cost of layoffs is high in Brazil, he explains, making hiring more expensive. In Europe, where laying off employees is very costly, the market adjusts by hiring fewer workers. As a result, youth unemployment is much higher. In Spain, for example, it has exceeded 50%.

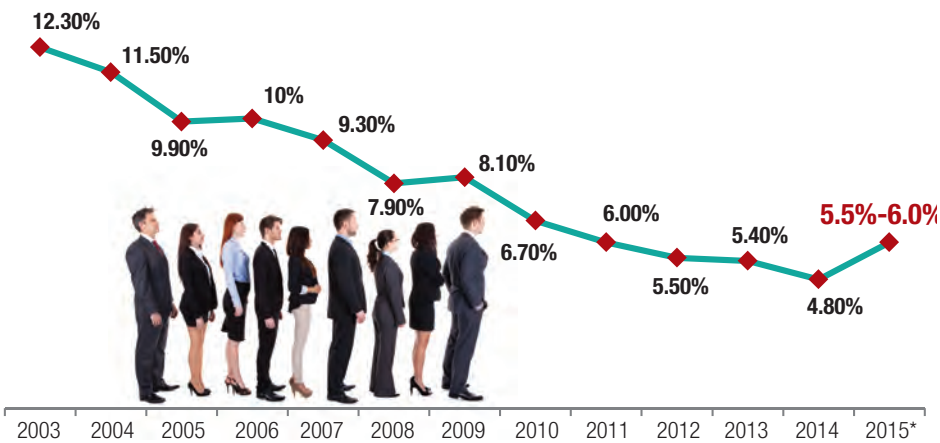
In a scenario of high inflation, meager economic growth, and loss of jobs, there is no doubt that workers lose. The question is for how long.

"The labor market is resilient, it takes time to slow down, but we are already seeing less employment in construction and services," says IBRE researcher Silvia Matos. Services and construction together account for over 70% of workers. With income growing less, the prospect is that households will cut their spending, principally on services, which would cause layoffs in the service sector, she predicts. She also notes that controlled prices (e.g., on energy) are rising, further reducing household incomes and forcing cuts in other spending.

Guilherme Mercês, economics and statistics manager of the Federation of Industries of Rio de Janeiro, also sees an unfavorable employment scenario: "Before 2010, industry's productivity was growing more than wages, which raised competitiveness and exports. That changed. Since 2010, wages have kept growing and productivity has stagnated, raising costs and lowering competitiveness. No wonder the trade balance deteriorated." However, recent government measures increase payroll taxes, making hiring more costly.

After a long decline. unemployment is expected to increase to 5.5-6.0% in 2015

(unemployment in six metropolitan regions)



* Forecast
Source: IBGE, IBRE staff.

> "The outlook for the labor market is bad and is likely to be aggravated by the fiscal adjustment and rising inflation, which creates uncertainty for businesses."
>
> *Naércio Menezes Filho*

Mercês says Brazilian unit labor costs in real terms increased 11.6% more than inflation from 2010 to 2014. Meanwhile, other countries have reduced their labor cost. Mexico and Colombia, he says, deregulated the labor market and unit labor costs declined by 6.3% for Mexico and 12% for Colombia.

More flexible rules

Mercês foresees rising unemployment in 2015, particularly in industry. The forecast is for industrial production to drop 1.1–1.2% this year. To reduce layoffs, he believes, it would be necessary to relax labor market rules, opening the possibility of direct negotiations between employee and employer, with the supervision of unions.

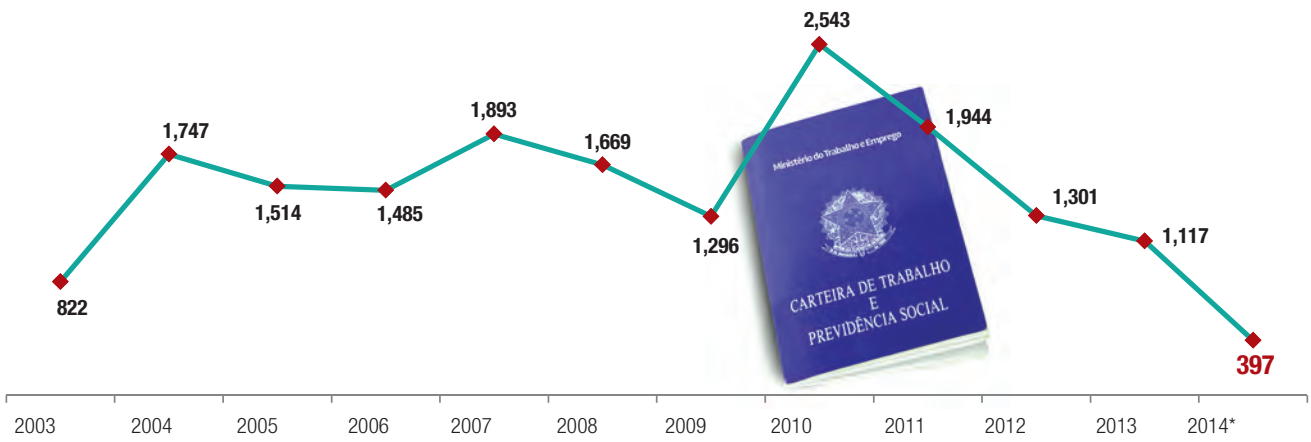
The technical director of the Inter-Union Department of Statistics and Socioeconomic Studies (Dieese), Clemente Ganz Lúcio, has a different diagnosis of the economic crisis, however: "There are inflationary pressures, in part derived from exchange rate devaluation, which is necessary for the development of industry. There are pressures derived from water scarcity, there is an adjustment in relative prices, and a correction of controlled prices. If all this is needed to rebalance the economy, we have to accept it."

Lúcio believes Brazil needs a transition, given the adverse international context with commodity prices falling, and Brazilian industry in fragile condition. He explains that "We had 25 years of destructive exchange rate overvaluation. Industrial policy measures were not enough to support industry. We have to reorganize the government to recover confidence." He fears that hitting the brakes too hard could cause a prolonged recession. In that case, business expectations would be even more critical to shaping the future.

"If companies feel that the outlook is positive,

The number of jobs created declined sharply in 2014.

(in thousands)



Source: Ministry of Labor.

they may retain workers, and the country could resume growth in 2016. In that case, companies would try to preserve their production capacity," Lúcio says. He believes the level of economic activity will depend on several factors, not just the government's actions, and that the international context will be decisive.

Dieese data, however, show that the slack labor market is not yet reflected in collective bargaining. In 2014, more than 90% of professional categories had their salaries and wages adjusted by the rate of inflation or more, but it is difficult to predict whether that will continue this year. The unions are not willing to watch passively as the labor market deteriorates; they are already mobilizing. "We must acknowledge that the economic situation is difficult, but we want to influence society and government policies," said Vagner Freitas, president of the Workers' Central Union (CUT).

Union proposals

"There is a debate on policies to strengthen the domestic market," Freitas says: "Some believe that this policy is no longer feasible. They want a change in policy that reduces investment and leads to economic paralysis. The CUT wants to discuss economic policies. So we are looking for partnerships with development economists, thinkers who share our vision. … We want to discuss proposals and take them to the Government, to Congress, to society. The policy agenda is the one that elected the president. … We need to discuss ideas that generate employment and income, and improve the competitiveness of domestic industry."

Freitas advocates cheaper credit from state-owned banks to revive the economy. "Another world is possible, rather than economic restrictions. The important thing is that this government was elected with the support of the working class and it needs to be encouraged to get out of the crisis." He fears that the discourse about the crisis may harm workers' collective agreements: "Brazilian businessmen may hide behind these arguments in order not to give wage increases and hire more."

> "Consumer and business confidence is worsening. There are high interest rates, credit restrictions, water crisis, and energy prices hikes. All this will deepen industry's downturn, which eventually will hit the service sector."
>
> *Rodrigo Leandro de Moura*

Miguel Torres, president of Union Force, is also in favor of measures to promote development. "We want to try to convince the government to adopt economic development and not profiteering. Meanwhile, the government has tightened credit and increased the tax on financial transactions. The Force will seek out government and Congress to encourage them to face this situation." He explains that "We are coordinating with Congress; we met with Renan Calheiros [Senate president] and Eduardo Cunha [president of the House]. Calheiros made it clear that he is against reducing workers' rights. We have also a fiscal adjustment proposal: reduce the number of ministries and departments. In addition, we propose taxing large fortunes and profit remittances as well as levying property taxes on helicopters, boats, and yachts. The adjustment cannot fall only on workers."

Torres says that to unlock investment businesspeople need to regain confidence. "The big challenge is to put more money into the economy, raise wages, and distribute income. We will have to face it," he urges. In a scenario of high inflation, meager economic growth, and loss of jobs, there is no doubt that workers lose. The question is for how long.

How to make Brazil more receptive to immigrant workers



The increased flow of immigrants into Brazil reinforces the need to modernize planning and legislation.

Solange Monteiro

THE PROFILE OF MIGRANT WORKERS has changed in recent years: Fewer Brazilians are working abroad, and more foreigners have entered Brazil's labor market. This change is reflected in Brazil's external accounts. Central Bank data show that in 2014 remittances from expatriated Brazilians fell by 35%, to US$1.9 billion; they had peaked in 2008 at US$2.9 billion. Meanwhile, the remittances of foreigners resident in Brazil shot up 94%, to US$1.2 billion.

The willingness of Brazilians to move overseas waned as the effects of the 2008 financial crisis waxed in the United States, spread in the world economy, and led some Brazilians to return home. According to the Organization for Economic Cooperation and Organization (OECD), the annual flow of Brazilian immigrants to OECD member countries fell from 108,000 in 2007 to 66,000 in 2012. Brazil's Foreign Ministry data indicate that, between 2007 and 2013, at least half a million Brazilians returned home. In contrast, the number of immigrant workers in Brazil increased by 19% in 2012 and another 27% in 2013 to total of 120,000 people, according to the Ministry of Labor. Most foreign residents work in the production of industrial goods and services (28%) or as, teachers of science and arts (20%), and directors and managers (15%).

Optimism about the Brazilian economy compared to the crisis in developed countries helped attract foreign workers.

In addition, the More Doctors Program of the Ministry of Health brought in 11,430 Cuban health professionals, and more Haitians came in on humanitarian visas. In 2013, Haitians became the main outside nationality in the Brazilian labor market, with 14,579 people, surpassing the Portuguese. "We are seeing the first significant inflow of immigrants since 1930. Brazil has not had its immigrant population renewed for a long time. The 2000 Census found that 38% of immigrants living in Brazil at the time were older than 65," says Leonardo Cavalcanti, co-author of the study "Integration of Immigrants in the Brazilian Market" (http://portal.mte.gov.br/obmigra/imigracao/).

"We are seeing the first significant inflow of immigrants since 1930. … The 2000 Census found that 38% of immigrants living in Brazil at the time had been here more than 65 years."

Leonardo Cavalcanti

Small population, high impact

In terms of the population of Brazil, the number of immigrants is relatively small. Language and its distance from centers of major geopolitical conflict are among the reasons why Brazil is less attractive to immigrants. Nevertheless, the increased number of immigrants is an opportunity to improve planning for and the laws governing immigration. "Today Brazil is not a receptive country for immigrants from the legal and political

Immigrants legally employed in Brazil

Main destinations of immigrants in Brazil

	São Paulo	Rio de Janeiro	Paraná	Santa Catarina	Mato Grosso	Brazil Total
2011	27,515	9,408	2,697	1,147	712	79,578
2012	33,172	11,022	3,890	1,875	892	94,688
2013	38,293	11,964	6,544	4,376	1,573	120,056

Main immigrants by country of origin

	Haiti	Peru	Colombia	Bolívia	South Korea	Africa (excluding Angola)
2011	814	1,019	496	5,835	723	1,148
2013	14,579	2,876	1,366	9,478	1,182	2,963

Source: Obmigra.

"Some Brazilians have improved their schooling and no longer want low-skilled jobs; on the other hand, we lack the scientists, engineers, technicians needed to increase productivity and innovate."

Naércio Menezes Filho

points of view," says Vanessa Oliveira Batista Berner, professor at the National Law School of Federal University in Rio de Janeiro (UFRJ).

Naércio Menezes Filho, coordinator of the Public Policy Center of the Institute of Education and Research (Insper), points out that the slowdown in the Brazilian economy reduces the need to improve conditions to attract foreign workers, but he notes that Brazil has shortages of high and low-skilled workers, which could jeopardize future GDP growth: "Some Brazilians have improved their schooling and no longer want low-skilled jobs; on the other hand, we lack the scientists, engineers, technicians needed to increase productivity and innovate."

In terms of attracting skilled workers, the main obstacle is the red tape for revalidation of degrees, which is done by public universities and takes an official period of six months. "As people graduate from recognized universities in their countries, the validation should be automatic,"



Most sought destination

São Paulo state employs more foreign workers than other states, but its share of foreign workers has declined from 35% in 2011 to 32% in 2013.

Menezes Filho says. "To some extent this reflects the corporatism inclination of the industrial sector, which resists the entry of professionals for fear of increased competition." Yet the inflow of skilled workers and professionals is closely related to foreign investment in Brazil. An example is the city of São Gonçalo do Amarante, Ceará state, where in partnership with Vale mining company South Korean corporations Posco and Dongkuk are building the Steel Company of Pecém (CSP). The CSP has 920 South Korean workers, almost 10% of its workforce, all in managerial and technical positions. Cavalcanti emphasizes that bringing in skilled labor will be a natural tendency to cover shortages of skilled workers as the population ages. Brazil, he says, will have to improve conditions to attract foreign skilled workers and compete with other countries also looking for skilled workers. "Despite the economic crisis, in Spain and Portugal there are many jobs for skilled workers."

Without crutches

Barriers to the flow of immigrant workers, however, affect the less skilled or refugees most. "Today the law creates obstacles to regularizing work permits for this group of people, creating an unfair situation when compared to skilled workers," says UFRJ's Berner. She was a member of the Expert Committee that produced the draft bill submitted last year by the Ministry of Justice to replace the 1980 Statute of Foreigners. "The current statute focuses on national security, not human rights," she says. The draft bill competes with two others that Congress is considering and would provide for establishment of a National Migration Authority to centralize management of visa processes and creation of a work visa that allows immigrants to seek employment in Brazil for a period of at least six months. "Today, if a foreigner finds a job opportunity in Brazil, he must return to his country to apply for a visa," Cavalcanti says. "This has created a large number of irregular workers in Brazil, which is estimated at anywhere from 180,000 to 600,000."

"Today Brazil is not a receptive country for immigrants from the legal and political points of view."

Vanessa Oliveira Batista Berner

Edilson Godinho of the Ministry of Social Welfare, Labor and Housing in Santa Catarina state advocates for closer coordination between levels of government in addressing the issue. His state showed the highest relative growth of immigrants formally employed, 133% in 2013, of which 29% are Haitians. "In the capital, in mid-2013 we helped an average of 40 to 60 Haitians a day through private employment agencies," said Godinho. Today, he said, the average has fallen to 5 a day, and among them are Angolans, Ghanaians, and Nigerians. He says, "We need federal support as well as to sensitize businesses, so that we have more resources and tools to deal with this new situation."

Berner believes that although Brazil is far from being a main migration destination, the tendency of human mobility is global and demands proper planning and legal framework. "Brazil has presented itself in international forums as a defender of human rights, but still lacks adequate, humanitarian legislation," she says, recalling slave labor allegations of Latino immigrants even today. Planning, she says, "is important not just for economic development but also for human and cultural development."

How well did state-owned banks expand access to financing?

A new study has found that after 2008, lending by state-owned banks mostly benefited companies that did not need support. Also, companies that have benefited from public credit did not invest more than companies that did not receive public loans.

Solange Monteiro

THOUGH STATE-OWNED BANKS have taken a larger share in the credit market since the 2008 crisis, they have not necessarily supported companies that were having difficulty in accessing finance because they were innovative, higher-risk, or smaller. These were among the findings of a new study by staff economists of the Center for Public Policy of the Institute of Education and Research (Insper) and the Central Bank, part of a continuing review of the current subsidized lending policy of state-owned banks, particularly the National Development Bank (BNDES).

In "Macroeconomic and Financial Consequences of Government Credit Expansion in the Post-Crisis," Marco Bonomo and Ricardo Brito of Insper, and Bruno Martins of the central bank research department analyzed about 1 million companies that each borrowed more than R$30,000 between 2004 and 2012 to assess how subsidized public credit affected their performance.

In general, during this period older, larger companies, with more employees and no default history were more likely to access public credit. Bonomo made it specific: "Our calculations show that a company 10 years older than another company would have been 3.3% more likely to get a credit loan before the crisis and 4.1% more likely after. And a company with twice as many employees than another would have been 5% more likely to get a BNDES loan." Another conclusion drawn from the study is that BNDES loans favored companies that were able to borrow in the private financial sector at lower interest rates, which indicates they were less risky.

Bonomo points out that the researchers did not have enough data to observe whether companies benefiting from public loans had experienced previous problems of credit restrictions or were active in helping bring about social gains. "Large companies with projects that generate social positive externalities, such as infrastructure, could justify government intervention," Bonomo says. However, the data allow the researchers to make some comments about how these loans affected company behavior. The researchers looked at the balance sheet and credit information of publicly traded companies and found, Bonomo says, that "Companies that have benefited from public credit did not invest more than companies that did not receive public loans." Furthermore, as expected, for companies that did receive

public credit the study showed increased indebtedness —which might be explained by company financial arbitrage in terms of seeking investments with rates of return higher than the cost of the loans—and a lower cost of capital.

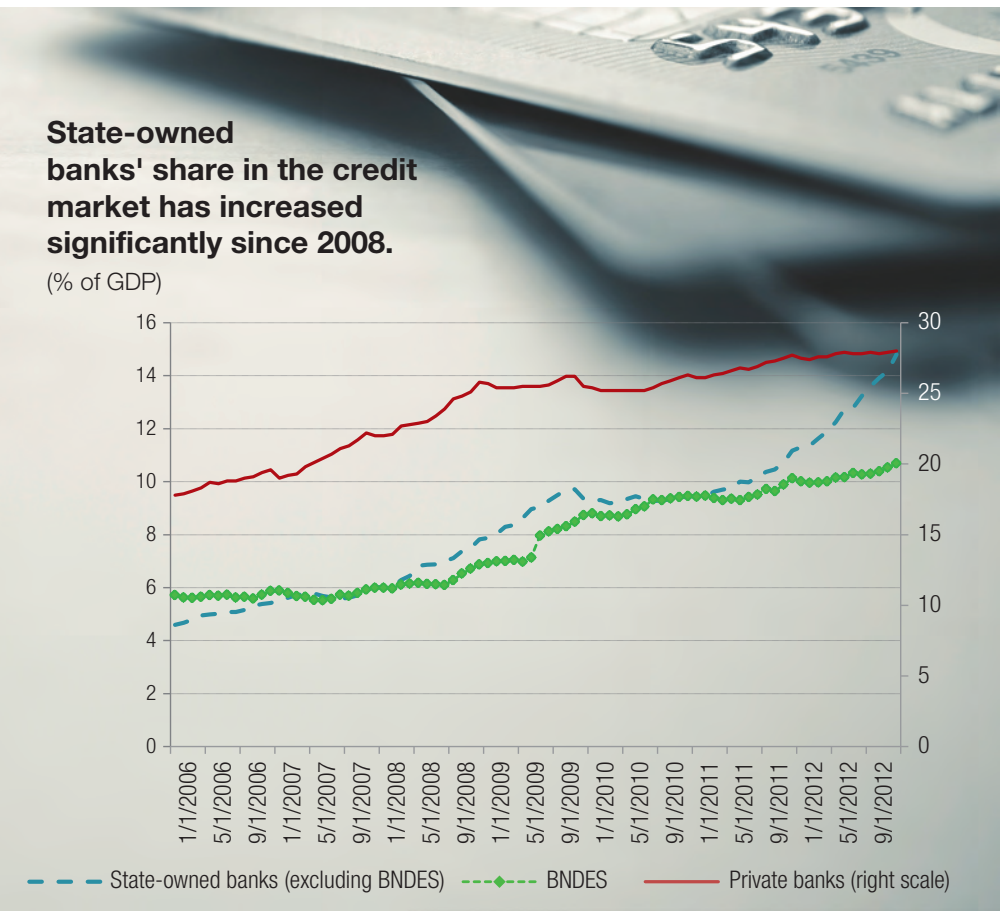
These results, Bonomo believes, are consistent with the view that the main effect of increased public credit was to shift demand for credit from private to public financing. He says, "Before the crisis, the expansion of credit in general was centered in the private sector. With the crisis, the government asked state-owned banks to make up for the fall in private credit, but then the government seems to have become excited and expanded public credit much more than private banks." The share of state-owned banks in total credit went up from 34% in 2008 to 48% in 2012. Bonomo points out that broad expansion of public credit can distort the allocation of resources between sectors and have a negative impact on both private banking and capital market. Also, as public credit is subsidized and regulated, he adds, it is not sensitive to the central bank policy interest rate, so monetary policy loses power.

Broad expansion of public credit can distort the allocation of resources between sectors and have a negative impact on private banking and on the capital market.

IBRE researcher Mauricio Canêdo argues for reviewing the granting of subsidized credit, especially by BNDES, to projects and companies that could be financed by the private financial market. "We indebted the Treasury, and now we cannot maintain the same level of lending as in the last five years," he says. "This forced reduction, however, is an opportunity to review the government's lending policy." His conclusion? "We have to be more attentive to the costs and benefits of the credit policy of state-owned banks."

State-owned banks' share in the credit market has increased significantly since 2008.

(% of GDP)



A recessive adjustment

Marcos Cintra

THE 2015 FISCAL ADJUSTMENT will bring about more recession than necessary because it rests more on increasing taxes than on cutting public spending. The economic research literature shows that fiscal adjustments based on cuts in spending are far more sustainable and of better quality than those that rely more on tax increases.

Reducing spending has clear advantages: it cuts fat and inefficiencies, fights corruption and "rent seekers" (those trying to obtain benefits for themselves through political connections), increases public sector savings, and reduces the tax burden on businesses, freeing resources for private investment. In contrast, although fiscal adjustments based on raising taxes are easier to carry out, they are recessive; they choke private investment and household consumption.

Alberto Alesina and Silvia Ardagna of Harvard University concluded that fiscal adjustments based on spending cuts and no tax increases are more effective in reducing fiscal deficits and the public debt-to-GDP ratio than when adjustments are based on increasing taxes. Moreover, adjustments in spending have fewer recessionary effects.

The fiscal adjustment in Brazil is the most perverse option, since it primarily involves raising taxes. Estimates are as yet preliminary, but it may make the tax burden much heavier by increasing tax rates, creating new taxes, and eliminating exemptions. The return of the Contribution of Intervention in the Economic Domain tax (Cide), the end of exemptions of the Industrial Products Tax (IPI), a higher Tax on Financial Transactions (IOF) and PIS-COFINS (Social Integration Tax and



Social Contribution Tax), the new tax on beverages and possibly on financial activities—together these may expand the tax burden by more than 2% of GDP, an increase of considerable magnitude.

Marcos Cintra holds a PhD in Economics from Harvard University and is Professor at the Getulio Vargas Foundation School of Business and Public Administration.



The fiscal adjustment in Brazil … may make the tax burden much heavier by increasing tax rates, creating new taxes, and eliminating exemptions.

On the other hand, even if absolutely necessary the public spending cuts envisaged are only hypothetical. The federal government's primary balance (budget balance excluding interest payments), which reached a surplus of 2.5% of GDP in 2007–08, ended 2014 with a deficit of 0.3% , partly because primary spending had gone up from 15.7% of GDP in 2002 to 19% in 2014, according to the estimates of Planning Minister Nelson Barbosa.

Unfortunately, spending related to the quality and availability of public services has not expanded in the same proportion as other spending. Spending on personnel, goods and services, and investment —which define the availability and quality of the public services offered to the population— decreased by 0.5 percentage points of GDP between 2002 and 2014, while total primary spending increased by 3.3 percentage points.

Inefficiency

It is not surprising that Brazilian society suffers from an inefficient public sector. Discouraged, poorly paid, and poorly trained staff and less public investment directly affect the quality of such essential services as health, education, security, and justice.

In contrast, spending on cash transfers, subsidies and tax exemptions grew explosively, from 6.6% of GDP to 10.1% between 2002 and 2014. This is a relative increase of 53%.

The urgency of the fiscal adjustment and the political difficulties of cutting social benefits and transfers have shifted the weight of fiscal adjustment to increasing the

Corporatism, demagoguery, populism, and "political correctness" have trumped objective questions of equity and efficiency.

national tax burden, which amounts to 36% of GDP, a level that is unprecedented for developing countries like Brazil.

The rigidity of public spending in Brazil deserves wide-ranging discussion. Reducing public spending is notoriously difficult worldwide, but it is particularly noticeable in Brazil, which in the late 1980s opted for significantly expanding social welfare programs without having the means to finance the expansion.

Corporatism, demagoguery, populism, and "political correctness" have trumped objective questions of equity and efficiency. Spending on social welfare programs is subordinated to the logic of income distribution and the alleged equality targets at any cost.

Supported by media and populist politicians, organized groups who feel disadvantaged by reductions in public spending, even though they are a minority, mobilize forcefully to defend their rights, at the expense of the social interests of the vast majority of the population. In this environment, cutting spending becomes a cyclopean task.

Another difficulty in cutting spending is Brazil's cumbersome process of public decision-making. Deliberative political bodies are numerous, and there are ample opportunities for intervention by the judiciary and various organs of control and supervision, official and private.

Moreover, the Brazilian budget process is incremental. Those who have worked in public administration know that the budget proposals for future years take as baselines current projects and programs. This practice works on the premise that current spending is justified by the simple fact that a program already exists. That leaves little room for spending cuts. Budgets become rigid, burdened by huge increments of mandatory spending.

Once incorporated into the public budget, social programs and activities are rarely evaluated to ascertain whether they should be continued or eliminated. They often turn into antiquated institutions unrelated to any real needs of a society in constant evolution. They survive by inertia, and sometimes without goals, but still consuming scarce public resources.

Finally, cuts in public spending in Brazil confront huge ideological, political, and operational difficulties. Only 10% of federal revenues are available for discretionary spending, such as investments. To complicate matters, during the presidential campaign President Rousseff said that "social spending" is untouchable, regardless of any objective evaluation of its merits.

To carry out the necessary fiscal adjustments expeditiously, the government should consider adopting zero-based budgeting, which every year evaluates the efficiency of the spending of the previous year. The zero-based budget would reverse current spending premises: it requires continuous evaluation of the effectiveness of public activities. Decisions to retain or eliminate programs and undertake new activities—and spending—require systematic and insightful annual assessments. Every year, each project, new or existing, must undergo a strict cost-benefit analysis before it can be included in the annual budget. If the government were to adopt zero-based budgeting, it would discover a plethora of spending that cannot be justified by any objective criterion of social value but that survives because of the sheer inertia of the public sector.

Photo: Fabio Tieri



What Brazil needs to really grow

Paulo Stark

CEO of Siemens in Brazil

Solange Monteiro

RESILIENCE AND FLEXIBILITY seem to be core beliefs of moderate optimist Paulo Stark, CEO of Siemens Brazil, when he talks about his business and Brazil's economy. Stark, an engineer who began his career with Siemens more than two decades ago, sees investment intentions being rethought as a result of the escalation of the crisis of state-owned oil company Petrobras, which could benefit the logistics and electricity sectors. "That will cause a gap until new projects are developed, but it is not a permanent problem," he says. However, to encourage new investments, he advocates both a concession model more open to private capital and longer-term planning for major infrastructure projects: "Sometimes we have the impression that Brazil needs a crisis to take a leap forward; now's the time to jump to avoid being run over."

***The Brazilian Economy*—With the gradual recovery of the U.S. economy and even a slow recovery in Europe, how do you think the global economic outlook will affect Brazil?**

Paulo Stark—The resumption of U.S. growth and the European Union's attempt to create an environment that fosters investments are very positive for Brazil. … Brazil is important for these countries; it has natural resources, commodities, and a large domestic market. Also, the U.S. recovery comes at a time when China is slowing down, which

A factor that most pessimistic scenarios are not taking into account is greater access to financing in the European Union because of credit easing, and the possibility that part of that capital will be invested here.

has raised concerns about sources of global growth. I think this is a good complement: I hope Brazil will to some extent reduce its dependence on exports to China and resume exporting to other economies.

Siemens is a supplier to a variety of industries. How do you see the outlook for industry generally?

In the market we're seeing a rather depressed attitude, with many people worried. But our long history here — in 2015 Siemens completed 110 years in Brazil— gives us resilience. I myself started working at Siemens in 1988; I've lived through hyperinflation, changes of currency, and markets going up and down. Today we have a diverse portfolio of products that in moments of crisis is a protection, because if we suffer in one market we can grow in another. And today what we see is a clear shift in investment focus—a rethinking.

Another factor that most pessimistic scenarios are not taking into account is greater access to financing in the European Union because of credit easing, and the possibility that part of that capital will be invested here. It is noteworthy that foreign direct investment flows into the country have stayed at relatively high levels, despite all the changes Brazil has experienced in recent years.

What are the implications?

Brazil has one of the lowest rates of total productivity in the world. Why is it lower? Is it because we cannot work productively within an industry? Or are we not using the assets we have in the best way possible? A factory in China will be operating 21 shifts a week. The same asset in Brazil may only be working 7 shifts, one a day. Businesses are not investing in automation because there is no demand for higher production. This is the dilemma: I do not invest because I have no demand, and I do not demand because I do not invest. This means these companies are prevented from participating in global supply chains. The world market is 50 times greater than the Brazilian market. Here a small or medium business invests in a piece of equipment to produce just for the local market, which means investing to meet the demand of a market only one-fiftieth the size of the global market. Meanwhile, the Chinese competitor is investing to serve the larger market.

What stimulus for industry is feasible given the government tightening policies?

This is a complex issue that involves many variables, but there are some things that would have positive impact. One of them is

the question of scale, to enable companies to participate in the global market. A few years ago the National Confederation of Industry Brazil did a study that produced some good insights (Industry Strategic Map 2013–22). But it will not work, in my opinion, if there are exemptions and tax benefits at the end of the production chain. There are so many inefficiencies along the production chain that even though the government grants tax exemptions at the end of the production chain, [domestic industry] will still be light years behind its global competitors. Scaling up production has to happen from the bottom up, in the first value-added steps, and go forward, year after year, throughout the production chain. We need to replace the current policy by facilitations at the beginning of the production chain, so that the first value-added steps are competitive globally, so that companies return to buy from local suppliers, and thus we will be increasing the scale, gaining competitiveness, and suppliers can start to export, too, and not depend only on the local market.

What is your outlook for public and private investment in Brazil?

Foreign as well as domestic investment has kept up a good pace in recent years, but though it is good compared to previous levels it still falls short of what we consider necessary. And investment will be directed where there is growth. One focus should be public-private partnerships, which will largely depend on government policy, rules, and the concessions program. A revised concession

Brazil has one of the lowest rates of total productivity in the world. Why is it lower? Is it because we cannot work productively within an industry? Or are we not using the assets we have in the best way possible?

program that is more open to private capital could dismantle many of the hindrances we have today and attract a lot of foreign investment in infrastructure, which is critical for the country's growth, in areas like energy, logistics, and water supply. There is no doubt that there is interest in investing here. But a little easing is necessary to keep this capital coming and reduce the need for public investment.

The regulations for concessions have generated considerable debate. One of the most criticized points is the question of the rate of return on investment. Do you agree?

My company does not invest directly in infrastructure, so I will give my own view. You cannot have an absolute discussion on the topic because the rate of return is very dependent on the amount of risk the investor has to take. So a low rate of return for a low risk can be attractive, even excellent, compared to investments abroad. More importantly, however, is the long-term perspective of a

Scaling up production has to happen from the bottom up, in the first value-added steps, and go forward, year after year, throughout the production chain.

particular concession and of the country's development strategy. For example, when someone invests in a port, the business case is of no use if the investor does not have a clear sense of the country strategy that will make that port important in 20 years. Long-term signaling—a more nonpartisan development policy—matters. Lack of a development strategy generates uncertainty for investors, who then try to optimize the return on investment and mitigate their risks in the short term. If we had a social pact related to the country's development strategy, it could change the game completely.

Your experience at Siemens includes time in Mexico and Germany. How do you see Brazil's innovation environment in comparison to those countries?

I am convinced that innovation within industry is not done by passing a law, but by economic logic. And this logic is connected to several factors. The first is the existence of some kind of comparative advantage. An obvious area here is agribusiness, and another is mining. There are others that can be created in the long term, through investments in education, universities, and basic research, which is what many countries are doing. When I hear about innovation here, I sometimes get the feeling that we're putting the cart before the horse. Choosing where to innovate through a decree might work in a protected market, but not in a free, global market.

We need to take the straightjacket off innovation and economic activity, and focus on identifying areas of comparative advantage. The Brazilian Corporation of Agricultural Research (Embrapa) created know-how without forcing farmers to use it. Farmers went looking for Embrapa when they realized that without this knowledge, they would be left behind. The same thing happens in industry. Entrepreneurs will only invest in R&D when they realize they need the knowledge to become more competitive. Brazil needs to improve education, identify more areas of comparative advantage, and make information available; then entrepreneurs will surely seek opportunities to build their businesses. Brazilians are good at recognizing business opportunities.

How does Siemens in Brazil see its operations in 2015?

Not just in Brazil but globally, we are drafting a business agenda based on three major aspects: electrification, automation, and what we call digitalization—business virtualization. What benefits does the agenda bring to Brazil? The entire infrastructure in every

industry obviously begins with bricks and mortar, but one of its foundations is electrification. In Brazil, there is an urgent need to expand electrification. Then we have automation, which allows companies to better use their assets. Finally, digitization allows for flexibility; it creates a virtual environment where I can plan, redesign, change flow, and then apply it, all in one operation. When we talk about smart grids, we mean reconfiguring the power grid by pressing a button. In Germany, and more widely in Europe, this process is called industry 4.0. Government agencies, ministries, and some companies, among them Siemens, are developing this technology and the necessary standardization for it to be widely used.

To what extent is Siemens worried about the uncertainties involving the oil and gas sector given the investigations of Petrobras?

Because of the diversity of our businesses, we have been seeing a clear shift in our customers' focus of investment. The value supply chain will seek to develop other businesses that may have been in the drawer or lower on the priority list. This reallocation process will cause a gap until new projects are developed, but it is not a permanent problem. Today we see more focus, for example, on energy. The question is how long this reallocation trend will last. This will depend on management's ability to get Petrobras beyond this situation so there is recovery before they turn off a large part of the production supply chain.

A revised concession program that is more open to private capital could dismantle many of the hindrances we have today and attract a lot of foreign investment in infrastructure, which is critical for the country's growth.

Will energy and infrastructure be important for Siemens this year?

The energy sector has risen in importance because of the electric power crisis. Today we are finally discussing pragmatically what kinds of energy we need in the energy matrix to solve the supply problem. We believe that there is also a good chance that logistics will heat up. No one is calm; no one is sailing in good weather. But sometimes we have the impression that Brazil needs a crisis to take a leap forward; now is the time to jump to avoid being run over.


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