Agribusiness
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Seminar
BRICS and the pursuit of growth

Interview
Luiza Helena Trajano
President of Magazine Luiza



THE BRAZILIAN ECONOMY

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Brazil's to-do list for growth: Where to start?

Economists discuss how to make the economy more efficient and growth sustainable

FGV IBRE

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The service sector has been the engine of the Brazilian economy, accounting for almost 70% of GDP, but it is now feeling the effects of household budget tightening and government spending cuts, as illustrated by lower sales and job cuts. Meanwhile, services inflation is growing. Cristina Alves looks at what's in store for the sector now that consumers have hit the brakes.

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Solange Monteiro parses recent discussions at an FGV seminar on commonalities and differences between BRICS countries, which are more an economic than a political bloc, as they all pursue sustainable growth. For instance, some supply commodities, some import them; for some the demographic dividend is just beginning, for others, like Brazil, it is tapering off. The experts also discuss what Brazil needs to do to compete.

Interview

36 "Our laws and bureaucracy do not encourage productivity"



Luiza Helena Trajano, president of retail dynamo Magazine Luiza and the new Institute for Retail Development, talks with Solange Monteiro about, among other things, the problem of low consumer confidence, wage questions, customer relations, how red tape makes retailing harder, and the need for Brazil to focus on productivity.

From the Editors

EARLY PREDICTIONS THAT the fiscal adjustment and greater transparency of public accounts—important factors to maintain for Brazil's international investment grade—would soon put the Brazilian economy back on the growth track have been watered down, destroying the possibility that growth would resume this year. IBRE staff now forecast that this year GDP will contract by 1.8% and inflation will be close to 9%.

The primary surplus target (what government saves to pay the interest on public debt) of R$66.3 billion (1.1% of GDP) seems increasingly distant, and gross public debt is expected to hit a new record of 62.7% of GDP by January. Government's efforts to shore up public finances have been complicated by falling tax revenues (4% less in May adjusted by inflation than in May 2014) caused by the steep economic downturn and Congress watering down some planned cuts in social security and unemployment benefits earlier this year.

To make matters worse, the services sector, which accounts for about 70% of GDP and was the one bright spot in the economy's mediocre performance, shrank 0.14% last year and is showing worrying signs of exhaustion and cutting jobs. The progressive loss of the purchasing power of workers is also being exacerbated by heightened inflation. As a result, declining consumer confidence is reducing consumption and deepening the downturn.

Although the government's efforts are commendable, fiscal adjustment and adjustment of relative prices alone will not be enough to put the house in order and the economy back on the growth track. The mountain of complex problems now plaguing the economy has been accumulating for years and addressing it has now become urgent. Resolution of these problems is complicated by the political crisis triggered by the investigations of corruption in state-oil company Petrobras and President Rousseff's record low approval rating. Building a long-term development agenda that goes beyond simple fiscal adjustment to focus on heightening productivity could be one way out of the current economy's quandary (see last month's issue). This policy view is widely shared by economic experts. This month's cover story anticipates the main points to be discussed at next month's IBRE seminar in Rio de Janeiro on Brazil's Growth Agenda.



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ECONOMY

Unemployment rises, wages fall

The unemployment rate climbed to 6.7% in May, up from 4.3% in December, and wages fell, government statistics agency IBGE said. Salaries discounted for inflation fell 1.9% month-on-month to R$2,117 (US$685), and sank 5.0% year-on-year. (June 25)

Consumer confidence, retail sales, down in June

The Getulio Vargas Foundation Consumer Confidence Index declined by 1.4% in June 2015 after two months of relative stability (June 26), and government statistics agency IBGE reported a continuing slump in sales, down 3.5% year-on-year in April. (June 16)

Industrial output up

In May industrial production in Brazil rose 0.6% month-to-month after three straight months of declines, IBGE said. Consumer goods production rose 1.4%. Nevertheless, industry contracted by 6.9% in the year to date compared with the same period in 2014. (July 2)

Inflation rises in June

The official consumer price index (IPCA) rose 0.79% in June, IBGE said, bringing rolling 12-month inflation to 8.89% through June, much above the 6.5% inflation ceiling set by the government. In June, the rise was attributed mainly to health, personal expenses and housing prices. (July 8)

POLITICS

Record low approval for Rousseff

President Dilma Rousseff's approval rating dropped to a record low, Datafolha polling results showed, amid sluggish economic performance and corruption allegations related to state oil company Petrobras. Only 10% of respondents ranked the Rousseff administration as "excellent or good," compared with 13% in the April poll; 65% of respondents said the administration was "bad or terrible," up from 60%. (June 21)

TRADE

Mercosur members disagree on EU trade agreement

With regard to a Mercosur-European free trade agreement under discussion, Argentina has reservations about the pact but wants to move forward as long as "not one job is lost" in Argentina, said foreign minister Hector Timerman. But Bolivia, an associate Mercosur member, said it will drop out if a free trade agreement is signed. However, after meeting with Brazilian Foreign Minister Mauro Vieira and delegates from Argentina, Paraguay and Uruguay, EU Trade Representative Cecilia Malmström said such discussion is too early: "We are not ready. No one is really ready to exchange offers. That's the reason why we decided to increase technical work and hope to exchange offers before the end of the year." In a joint communiqué both sides agreed that they had "a frank and open exchange on the state of negotiations for an agreement ... (described as) ambitious, comprehensive and balanced … The objective will be to exchange market access offers in the last quarter of 2015." (June 12)

Lift for Brazil beef exports

Argentina has lifted an embargo on imports of Brazilian beef, Brazil's agriculture minister Katia Abreu said. Abreu also expects the United States to start importing fresh Brazilian beef by August and is working to open Japan's market. China suspended a ban last month, during a visit of Chinese Prime Minister Li Keqiang to Brazil. (June 17)

Japan takes Brazil to the WTO

Japan launched a complaint against Brazil at the World Trade Organization on Thursday to challenge charges and taxes it says illegally favor Brazilian-made over foreign goods. Japan says Brazil imposes a higher tax burden on importers and provides export-contingent subsidies, affecting sales of Japanese cars, semiconductors, smartphones, software, and other hi-tech and automation products, the WTO said. Brazil has 60 days to settle the complaint, after which Japan could ask the organization to adjudicate. (July 2)

INTERNATIONAL

EU-Brazil relations warm up

U.S. President Barack Obama and Brazilian President Dilma Rousseff recently met at the White House to turn the page on a spying scandal that had damaged relations and said they want to work to bolster economic ties. The presidents welcomed the "imminent opening of fresh beef trade" between the two countries, they said in a joint statement. They also agreed to take steps so that Americans and Brazilians can travel between the two countries without visas and to allow Brazilians to apply for expedited "global entry" into the United States in early 2016.

Obama praised Brazil during Tuesday's press conference as a "global power" and an "indispensable partner" in addressing climate change with a deal to boost production of renewable power. (June 30)



Photo: Roberto Stuckert Filho/President's Office.

Presidents Dilma Rousseff and Barack Obama mend fences.

ECONOMIC POLICY

Court of Audit questions administration accounts

The Court of Audit has called upon the administration to explain alleged irregularities in the 2014 federal government. The unprecedented decision could force the government to alter its fiscal targets for this year. The decision was hailed by analysts as showing the increasing strength and independence of the country's institutions and improving the transparency of public accounts. The court gave the Rousseff administration 30 days to explain a series of accounting measures undertaken by the government last year, and questioned 2014 budgetary practices, such as running up debts with state banks. (June 17)

Temporary pension system fix

President Dilma Rousseff has issued a rule limiting pension benefits in an attempt to contain the social security deficit. The new rule differs from a recent Congress-approved formula that would substantially boost pension payments. Rousseff had vetoed a bill that would allow people to retire earlier. The new formula will save government US$16.7 billion in spending through 2026, Planning Minister Nelson Barbosa said. It will also likely raise tensions with union bosses and legislative allies who have threatened to override the veto in order to retain a more flexible retirement age. (June 18)



Photo: Marcelo Camargo/Agencia Brasil.

Finance Minister Joaquim Levy is concerned about failure to adopt fiscal measures.

Central Bank 2015 forecast: 9% inflation

Brazil will end this year with inflation of 9.0%, the central bank said in its quarterly inflation report, compared with its March forecast of 7.9%. The bank emphasized that progress in combating inflation "is still not sufficient." (June 24)

Congress fights back at Rousseff initiatives

The Senate has passed a bill that would raise spending on salaries by R$25 billion reais (U$8.1 billion) over four years. The boost affects workers in the court system. Delcidio do Amaral, the government's leader in the Senate, said Rousseff will veto the legislation, which the lower house has already approved. Finance Minister Joaquim Levy has cautioned that failure to adopt the government's fiscal-tightening measures could result in a sovereign-credit downgrade. (July 1)

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Brazil's to-do list for growth: Where to start?

Economists discuss how to make the economy more efficient and growth sustainable

Solange Monteiro

THE SECOND QUARTER CLOSED WITH negative numbers for the Brazilian economy and fading hope that it will soon be possible to discern whether the economy was heading to recovery. The government has reacted to the dim economic prospects with measures directed to two sectors considered vital for growth: infrastructure (the Investment Program in Logistics, PIL) and exports (the National Export Plan, PNE). Their success, however, will depend on the ongoing macroeconomic adjustment and structural reforms to increase efficiency and enhance quality and economic stability.

What are the best policies for Brazil will be addressed at the "Agenda for Brazil's Growth" seminar sponsored by the Brazilian Institute of Economics on August 6 and 7 in Rio de Janeiro. "We are gathering researchers to discuss the dynamics of sources of growth and the structural changes needed to accelerate the country's growth potential," says Regis Bonelli, IBRE researcher and seminar organizer.

Participants will begin by identifying the relative weight of the international crisis and domestic factors in Brazil's recent economic turndown. "At the end of last year the debate [on the causes of the economy's turndown] was polarized, but binary views are unable to give a satisfactory explanation," says Bráulio Borges, chief economist at LCA Consultancy. Using the International Monetary Fund database on 183 countries, Borges found that Brazil's GDP per capita grew 1.6 percentage points less in 2011–14 than in 2003–10, while the average for all countries was only 1 percentage point less growth. He concluded that about 60% of Brazil's downturn was due to the global slowdown and 40% to domestic factors. "Brazil came out of the 2009 crisis very fast. GDP did not suffer because the government administered large doses of stimulus to the economy in that period, but that has since taken its toll on the economy," he says. Borges explains that, when consumption is stimulated, growth improves in the short run but then loses strength.

IBRE researcher Silvia Matos believes that government efforts to support growth at the height of the crisis have generated more domestic imbalances in the economy than gains. "Most countries that are dependent on commodities exports, like Chile and Peru, have not slowed as much as Brazil," she points out, which suggests that the quality and credibility of the economic policy of the two countries have to some extent offset lower external demand and commodities prices. Matos and

When consumption is stimulated, growth improves in the short run but then loses strength.

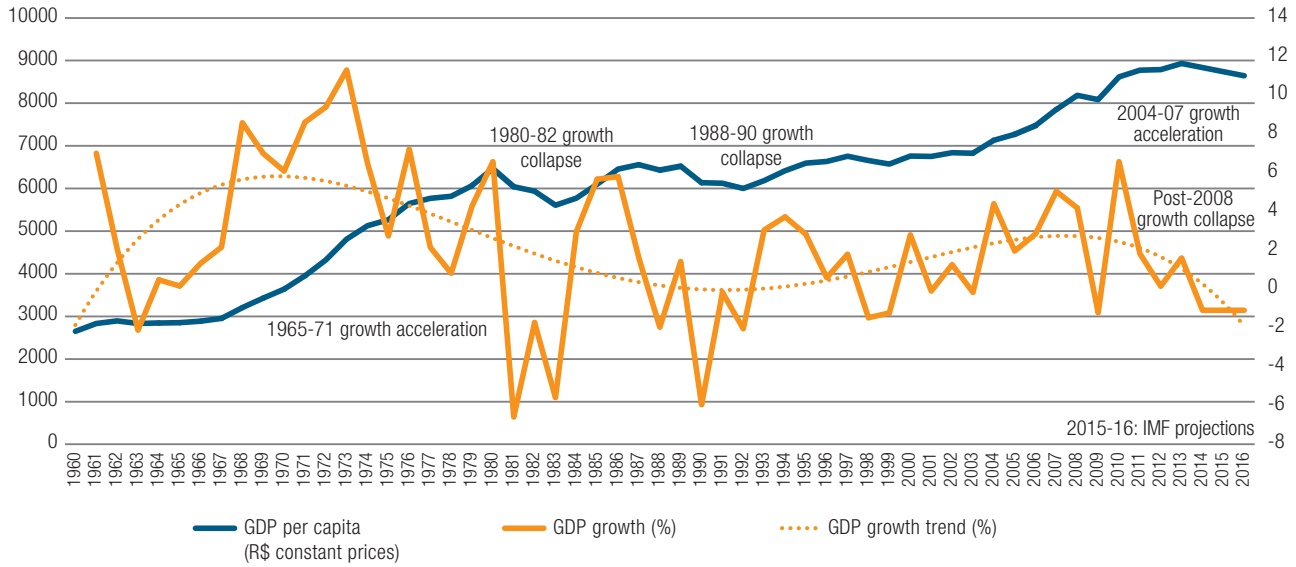
her IBRE colleague Vinicius Botelho compared recent growth of developing economies. In six countries—Brazil, Argentina, South Africa, Russia, Turkey, and India—growth slowed more than expected, and Brazil's slowdown is explained in part by less private sector confidence, which generally indicates poor management of the economy. This reinforces the theory that Brazil's slowdown is related more to structural than to cyclical factors. In Brazil, Matos says, "The loss of confidence is related to a mix of expansionary fiscal policy, higher inflation, a larger external current account deficit, and price mismatches of fuel and energy. This has generated imbalances in the economy that are difficult to correct."

Volatile growth and demographics

The lack of capacity to promote balanced and sustainable growth is not new for Brazil. Jorge Arbache, professor of economics at the University of Brasilia, points out that the country's growth is among the most volatile in the world, even compared with some African nations. Arbache says that periods of expansion and contraction since 1960s each took six to seven years, punctuated by many swings and large variations. The growth

Brazil's GDP growth is among the most volatile in the world

(GDP per capita in R$ constant prices, and GDP growth)



Sources: IMF, and Jorge Arbache.

volatility has not been neutral, he says: "Reactions are asymmetric. While investment may fall less when an economy is contracting than when it rises during the expansion period, income inequality and poverty deteriorate more during the contraction than they improve during expansion," he explains. As a result, growth in Brazil's GDP per capita is relatively low compared to other emerging economies.

Government efforts to support growth at the height of the crisis have generated more domestic imbalances in the economy than gains.

Arbache thinks that Brazil's volatile growth calls for policies to help sustain growth, such as incentives for innovation and adoption of technology. But he notes that the country has lost room for maneuver. A main limiting factor is demographic: Families are reducing the number of children fast for an emerging economy and eventually that will reduce the workforce.

João Ronaldo de Castro and Paulo Levy, researchers at the Institute for Applied Economic Research (IPEA), point out that since 1970 Brazil's workforce has grown faster than the total population, allowing GDP per capita to grow above productivity. "This situation will be reversed after 2020," Castro says. "To raise the standard of living, labor productivity will have to grow much faster than it has in the last 30 years."

The end of the demographic bonus will reduce the number of people of working age. This will reduce savings and raise the number of people dependent on pensions and health care, pushing up public spending. Castro and Levy estimate that the reduction in workforce growth will limit the growth of the Brazilian economy to no more than 2% a year, assuming savings and investment at current levels and constant total factor productivity (TFP) of 1% a year—close to the historical averages estimated by Regis Bonelli and Edmar Bacha.

Brazil's slowdown is explained in part by less private sector confidence, which generally indicates poor management of the economy.

Dwindling savings

Brazil's low personal savings exacerbated by historically low public savings raise the cost of capital and reduce fixed investment. Mansueto Almeida of IPEA points out that "In the 1970s, public sector savings were between 6% and 7% of GDP and boosted fixed investment. Those savings vanished during the 1980s, especially after the Constitution of 1988, which created a fiscal stance not propitious to increasing public sector savings. … If the current fiscal stance continues, even if the economy grows more, the public sector will still record savings that are negative or close to zero."

Without domestic savings, increasing fixed investment by 4–5 percentage points of GDP will require foreign savings, which with the end of the commodities supercycle would make the current account deficit unsustainably large. "Australia has done this for more than two decades, but it has consequences," said Almeida, noting that countries that use foreign savings to grow need strong capital inflows, which implies currency appreciation, and that undermines industry.

Almeida believes that changes in access to unemployment insurance, salary bonuses, and sick leave pay are only the beginning of what is needed to correct anomalies in the social safety net, which eventually will have to address social security pension reform, especially the minimum retirement age. "That does not mean we have to solve everything in three years. When Margaret Thatcher reformed the social security system in the UK, it took two decades. Nevertheless, we have to begin a serious debate about it," he says. "The government estimates a social security deficit of 1% of GDP by 2020, but it was already 1% last year. If we add in other demands, such as health and education, the government will have to increase the tax burden by 10 percentage points of GDP over the next 20 years, as it has done since the 1990s."

"The government estimates a social security deficit of 1% of GDP by 2020, but it was already 1% last year. If we add in other demands, such as health and education, the government will have to increase the tax burden by 10 percentage points of GDP over the next 20 years."

Mansueto Almeida

Almeida believes this scenario of restrictions should also stimulate corrections in government budget planning. "Today we have a budget with unrealistic inflated revenues that forces government to control spending," he says. In his opinion, programs should only be expanded when there is fiscal space. "Over the past five years, National Development Bank–subsidized loans to the private sector have cost the Treasury nearly R$40 billion a year," he explains. "The My House My Life program cost R$18 billion in 2018. Are these expenses bad? No—as long as we have the resources to pay for them."

Infrastructure

IPEA's Marco Antonio Cavalcanti says that better fiscal management is critical to a more promising scenario for investment in the long term. "We have to look at the ongoing adjustments in the economy with optimism; it is a cost to pay for a better situation in the future," he says.

Marcio Pochman, professor at the University of Campinas, believes that consumption-led growth could be partially reversed with the change of interest rate policy. "Since 1990s, Brazil has had one of the highest interest rates in the world. That's a premium for nonproductive investment. As a result, growth in recent decades was limited to consumer cycles," he says. Pochmann argues for a long-term investment plan as a way to take the focus of the Brazilian economy off consumption and the short term. "We need to address a broader issue: the lack of a national project. Unfortunately, the country is completing four decades of being tied to a short-term plan," he said. Since the 1970s, he notes, Brazil has not been able to boost an investment-led expansion cycle, which is critical for sustainable long-term growth.

With R$189.4 billion budgeted for fixed investments, the new phase of the new PIL investment program is government's tap to turn on the virtuous investment-growth cycle. IBRE researcher Armando Castelar thinks the program has benefited from lessons learned from previous mistakes: "Now there are concessions for shorter sections of roads that can attract more businesses; also rules for the railway sector were changed." But, he adds, a lot has not yet been defined,

highlighting uncertainties about such barriers to investment as the government's emphasis on low tariffs. He also pointed out the need to make spending on infrastructure more efficient. Castellar emphasizes the importance of better management of such regulations as environmental licenses. For example, "The project to divert part of the São Francisco River to supply drinking water was planned for completion in 2010 at a cost of R$4.5 billion; the cost is now estimated at more than R$8 billion without a drop of water yet flowing."

"To raise the standard of living, labor productivity will have to grow much faster than it has in the last 30 years."

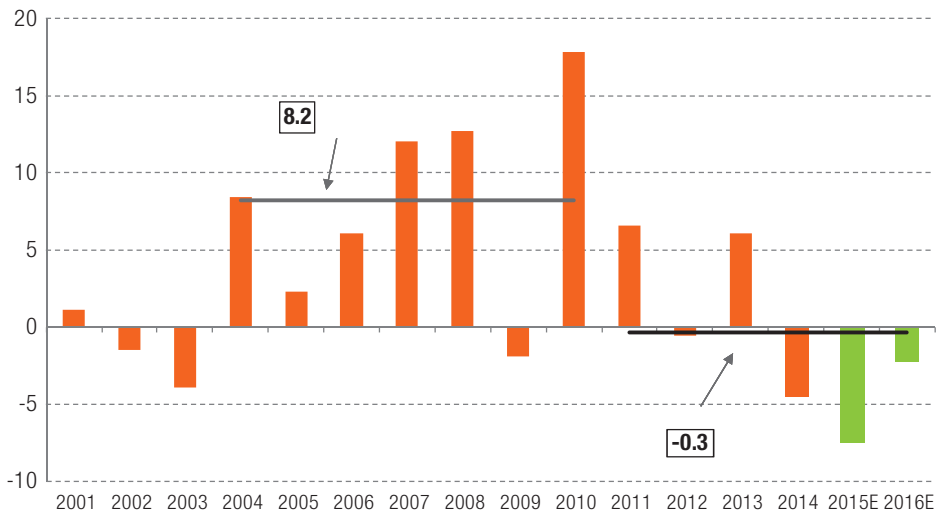
João Ronaldo de Castro

Productivity

There is a general consensus on the need for more efficient use of production inputs. Pedro Ferreira Cavalcanti of FGV Growth and Development, points out, for example, that low production efficiency accounts for almost two-thirds of the 80% income gap between Brazil and the United States. Among factors that depress productivity are bureaucracy, corruption, and micromanagement of the economy, all of which affect the business environment.

Brazil's fixed investment growth declined substantially during 2011-2014, and is expected to fall by 7% in 2015

(Annual % growth)



Sources: IBGE and IBRE.

Low production efficiency accounts for almost two-thirds of the 80% income gap between Brazil and the United States. Among factors that depress productivity are bureaucracy, corruption, and micromanagement of the economy.

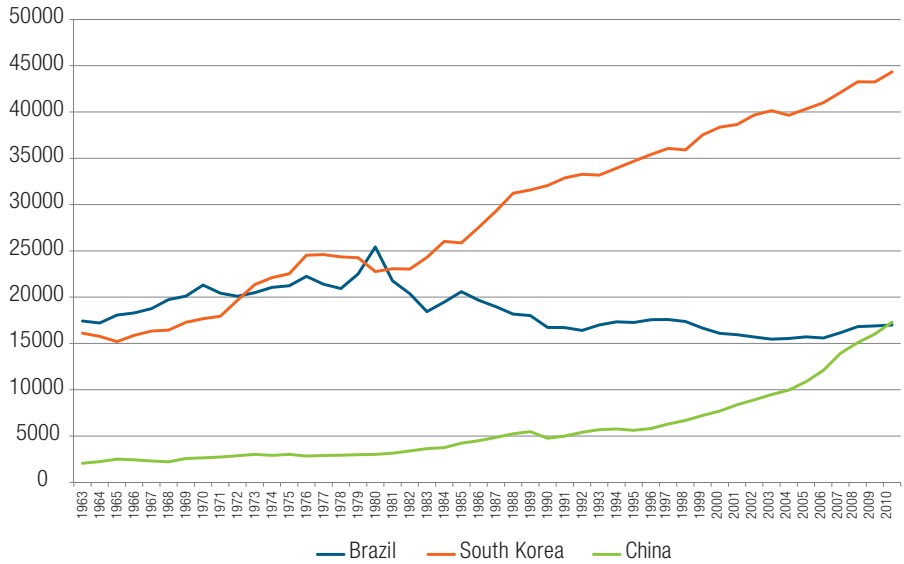
"An infrastructure investment plan is a virtuous adjustment that promotes productivity," IPEA's Cavalcanti says. "The only way for economic growth to resume in the short and medium term is to increase exports of manufactured products, and that depends crucially on better transport infrastructure, wage moderation, and careful adjustment of the exchange rate," says José Luis Oreiro of the Federal University of Rio de Janeiro. Oreiro believes that the competitiveness of Brazilian exports depends on an exchange rate of more than R$3.50 per US dollar. "If we again stop adjustment of the economy, we will reap the worst of both worlds: we will have a stagnant country and high inflation," he says. In his opinion, "The central bank could reasonably work with a longer horizon to meet the inflation target, possibly in 2017 or 2018. If the period to meet the target was extended, we could stop raising interest rates, with less sacrifice in terms of income and employment."

Nelson Marconi, IBRE researcher, argues that the competitiveness of Brazilian industry depends on policies to reduce costs. "This requires an appropriate tax structure for the productive sector, with differential treatment for imports used by those who export," he says. Marconi also suggests an improvement in the cost of financing, with special credit lines for companies that fulfill export targets. "This could also apply to investment in innovation, with a line of credit. Rather than being inconsequent protectionism, this would create incentives and encourage companies to invest in innovation," he says.

Fernanda De Negri of IPEA points out that investment in innovation, which is a major productivity-enhancing factor, is cyclical and has declined in recent years. Data from the Innovation Survey by Pintec and IBGE show that the largest recent investment in innovation occurred in 2005–08, but the distance separating Brazil from the technological frontier has not changed because similar expansion happened elsewhere in the world and, in relative terms, Brazil remained in the same place. The risk, in fact, is going backward. According to the Brazilian Agency for Industrial Development (ABDI), in late 2014 the rate of innovation in Brazilian industry was back to one of the lowest values at the start of the series in 2010. The share of manufacturing firms with more than 500 people that have invested in product and process innovation dropped from 27.8% in the first quarter of 2011 to 17.1% in the fourth quarter of 2014.

Brazil's service sector has low and declining productivity compared to South Korea and China

(US$ of 2005 per worker)



Source: IBRE.

Enhancing productivity in services

Supporting growth will require making the service sector more productive, because that sector accounts for 70% of GDP. "Brazil's service sector became large prematurely, making a structural transformation in reverse by transferring resources from more productive sectors to less productive service sector," Arbache says. "A large, inefficient, and expensive service sector like ours contaminates other sectors of the economy."

Fernando Veloso, an IBRE researcher, points out that unlike South Korea, where services have high added value, in Brazil they are concentrated in low-skilled activities. "In Korea, highly skilled workers represent 51.4% of the total workforce; in Brazil skilled workers account for only 23.3%," he says.

Arbache believes that today Brazil's economic structure and poor-quality education reflect an excessively closed economy. "Because the economy depends too much on agriculture and mining, and industry is protected from competition, there is not much demand for skilled workers," he says. "Brazil started paying attention to education in the 1990s, when the country began to open up the economy to international trade, but South Korea, Singapore, Japan had already done it," he says. "Today we have to take a quantum leap. We should consider education as a wealth creation tool and include it definitively in the policy agenda," he concludes.

What should be on Brazil's trade agenda

Solange Monteiro

The external outlook for boosting the Brazilian economy through exports is somewhat gloomy. In the euro zone, despite the devaluation of the euro against the dollar, the oil price fall, and the bond purchase program of the European Central Bank, in the first quarter GDP recorded only modest growth. Now Greece is again depressing investor confidence and threatening the EU recovery. In China, lower interest rates and the reserves required in June for banks pointed to the difficulty the government has had in containing the economy's slowdown to 7% growth. In the United States, at the last meeting of the monetary policy committee of the Fed, Chair Janet Yellen signaled that, although there is a possibility of raising the interest rate later this year, normalization of the U.S. economy will be more gradual than previously anticipated.

At the last meeting of the U.S. Fed monetary policy committee Chair Janet Yellen signaled that, although there is a possibility of raising the interest rate later this year, normalization of the U.S. economy will be more gradual than previously forecast.

At the IBRE seminar on economic analysis held in June, José Julio Senna, head of the IBRE Monetary Policy Center, noted that the downward revisions in basic interest rate projections of the US economy immediately reflected positively on prices for commodities exported by Brazil. "Markets are also accepting more risk, increasing demand for Brazilian bonds," he says. On the one hand, this outlook will improve capital inflows to Brazil, giving the economy more time to adjust; on the other, it sounds an alarm about weak external demand. "In the first quarter consumption was below disposable income, which indicates that Americans are not going shopping," he says.

Otaviano Canuto, former Executive Director of the World Bank, warns, though, that

Brazil should not wait for a more favorable international outlook to promote its exports. Canuto recommends that Brazil should consider the extent to which its economy may be too closed, noting that "In general, large countries have relatively lower imports and exports. However, in six larger economies than ours, trade (exports plus imports) accounted for 55% of GDP in recent years, compared with 27% in Brazil." Among Brazil's BRICS partners, trade accounts on average for 50% of GDP. Canuto suggests that Brazil's low trade numbers reflect the country's limited participation in global production chains: currently, the domestic value added to Brazilian manufactures is 93%, compared to 70% in Mexico and South Korea. "This shows that the division of the production process along transnational value-added chains—the second wave of globalization—has passed Brazil by," he says.

Brazil's exclusion from international trade reflects its economic and trade policies, says Canuto. To improve this situation, he argues that Brazil should address such old problems as its precarious logistics and the high costs involved in international trade, and prioritize macroeconomic management so that it does not hinder trade. "The temptation to let the exchange rate appreciate to bring inflation down should be avoided at all costs," he says. Protectionist policies should also be rolled back.

Brazil should maintain a trade-positive agenda with the United States and Europe to mitigate the potential negative effects of such trade agreements as the Transatlantic Partnership on Trade and Investment between the U.S. and Europe and the Transpacific Agreement.

Canuto believes the government's priorities now are to maintain a flexible exchange rate regime to balance external transactions, improve the country's business environment, and promote tax simplification. "It is possible that these changes will cause some companies in the production chain to disappear and be replaced by imported products. But companies that survive will be more competitive and produce better-quality goods," he says. Canuto argues that Brazil should maintain a trade-positive agenda with the United States and Europe to mitigate the potential negative effects of such trade agreements as the Transatlantic Partnership on Trade and Investment between the U.S. and Europe and the Transpacific Agreement. "These agreements will have costs for Brazil but they need not be disastrous," he says.

Inclusive development





Chico Santos

WHEN ON MAY 6, 2015, she signed Decree 8447, which created the Agricultural Development Plan of Matopiba (PDA Matopiba), President Dilma Rousseff was not just launching yet another of the many, often ineffective, development programs Brazil has known. She was formally creating an interstate region with its own characteristics that since the 1980s has shown significant agricultural development and has already been termed Matopiba, consisting as it does of Maranhão, Tocatins, Piauí, and Bahia states.

Based on a study by Strategic Territorial Intelligence Group (Gite) of the Brazilian Agricultural Research Corporation (Embrapa), Matopiba is an area of 73 million hectares (180 million acres) in the four states. According to Gite coordinator Evaristo de Miranda, Matopiba's grain production rose from 2.5 million metric tons in 1993 to 18.6 million metric tons in 2014 and should reach 20.4 million metric tons this year—about 10% of Brazilian agricultural production. The creation of Matopiba launches programs of incentives, credit, and technical and social assistance.

However, many hope that the Matopiba plan will mitigate the effects of uneven development in the region driven by expansion of agribusiness. "The Matopiba region is an archipelago of islands of prosperity in a sea of rural poverty," Miranda said. The GDP per capita of the region is R$7,950, below the national average of R$19,770.

According to a study by Embrapa researchers Eliseu Alves and Geraldo da Silva e Souza, based on the 2006 Agricultural Census of the Brazilian Institute of Geography and Statistics agency (IBGE), of the 250,000 farms in Matopiba, 94% are owned by farmers who are poor (14%) or very poor (80%). The very poor earn no more than twice the minimum monthly wage per month (US$525), and poor

farmers earn two to ten times the minimum wage (US$2,626). In contrast, middle-income farmers earn up to 200 times the monthly minimum wage (US$52,533) and rich farmers earn far more than that.

In Matopiba, Alves and Souza found that the average monthly income of very poor farms is just 0.48% of the minimum wage (US$126) for a family of four. "About 800,000 people have no way to survive on their farm output. They complement their income by working elsewhere and with cash transfers from federal, state and municipal governments," the researchers concluded.

Lacking technology

By dividing the region by farm size—up to 100 hectares (247 acres) and more than 100 ha—Alves and Souza were able to identify the biggest problem of Matopiba farmers: Although there are land issues, lack of access to technology explains most of the difference of income among farmers.

"The Matopiba region is an archipelago of islands of prosperity in a sea of rural poverty."

Evaristo de Miranda

Of the 250,000 Matopiba farms, 213,493 (85%) had less than 100 ha and only 36,346 were larger. Yet of the total area of 73 million ha, 85% were held by farmers whose holdings were over 100 ha. "Given the concentration of land in the hands of farmers that have more than 100 ha, it is natural to relate the inequality of incomes to the concentration of land ownership," Alves and Souza said.

Looking at the distribution of income, the researchers found that very poor farmers have 85% of the individual properties but account for only 19% of income, poor farmers have 11% of the properties and 24% of the income, and middle-income and rich farmers have 4%

Matopiba

Distribution of production and income



	Share in total farms (%)	Number of farms	Share of gross income (%)	Gross income per farm (minumum wage per month)
Very poor	79.8	199,801	5.2	0.48
Poor	13.9	34,917	8.4	4.36
Middle income	5.8	14,500	26.7	33.64
Rich	0.4	1,020	59.7	1,067.21
Total	**100.0**	**250,238**	**100.0**	**7.29**

Sources: Agricultural Census 2006, and Alves and Souza.

Of the 250,000 Matopiba farms, 213,493 (85%) had less than 100 hectares and only 36,346 were larger. Yet of the total area of 73 million ha, 85% was held by farmers whose holdings were over 100 ha.

of the properties but account for 57% of the income. This finding is confirmed when we look at income distribution among farmers with properties larger than 100 hectares: about 80% belong to very poor and poor farmers, but they only account for 4.6% of the income generated by large farms. "In other words, the production and income of poor farmers are low not because of shortage of land but because of technological backwardness," Alves and Souza concluded.

They also concluded that the problem is more critical in farms that are smaller than 100 ha. They estimate that for farms of less than 100 hectares, increasing income depends more on improved technology than labor and land (71% technology, 16% labor, and 13% land).

They also found that almost 200,000 poorer farms are spread over all 337 municipalities of Matopiba. "The solution for the extreme poverty problem will require reorganizing production, and improving access to technology, inputs and credit. Until this can come about, income transfer policies are a viable option as an alternative to rural exodus," Alves and Souza said.

Alves also pointed out the need to improve infrastructure in the region. Minister of Agriculture Katia Abreu has launched a program to link the producing regions of Matopiba to the ports and consumer regions and reduce the cost of transporting crops to market.

Regarding access to technology, Alves believes that the greatest difficulties are in "market imperfections." Among the imperfections that hinder the development of poorest farmers, Alves highlights the difficulty to obtain credit, poor access to electricity, and crop prices lower than inputs. One of the alternatives being considered is to find a way to join disadvantaged farmers into associations or cooperatives so they can get better prices to pay for their inputs.

Alves believes that specific policies are essential to help correct market imperfections that hamper the development of disadvantaged farmers. Otherwise the Matopiba plan would replicate what has happened in other areas of Brazilian savanna, as in Goiás state, where, he said, "the spectacular modernization" has not benefited the people of Goiás. Without policies to correct market imperfections, he believes local farmers will be gradually forced to sell their farms to producers coming from outside.

The first step

The Gite-Embrapa study has shown that Matopiba's share in agricultural production of the four states in which the region is inserted increased from 35% in 1996 to 40% in 2006 and, according to Miranda, now exceeds 50%. In the period between the two agricultural censuses, temporary crops (mainly soybeans) grew faster, accounting for 75% of total production value, up from 44% and replacing livestock whose share dropped to 8% of total production value, down from 39%. permanent crops also had a significant increase in production between 1996 and 2006, from 4% to 7% of the total production value, which amounted to an increase of 72.2%. The share of forestry and horticulture also increased.

For farms of less than 100 hectares, increasing income depends more on improved technology than labor and land (71% technology, 16% labor, and 13% land).

Regarding infrastructure, Daniela Rocha and Ignez Lopes, IBRE researchers, based on data of the National Confederation of Transport (CNT) found that much of the road transport infrastructure in the region needs better maintenance. In 2014 the CNT annual survey classified 65% of the roads in the



Matopiba

11 regions with large grain production and high productivity, 2011

Micro-region	Harvested area (ha)	Production (metric tons)	Productivity (Kilograms per ha)
Porto Nacional/Tocantins	125,468	343,014	2,734
Alto Médio Gurguéia/Piaui	164,803	463,315	2,811
Gurupi/Tocantins	64,887	189,968	2,928
Chapadas das Mangabeitas/Maranhão	168,299	497,229	2,954
Dianópolis/Tocantins	80,083	238,975	2,997
Gerais de Balsas/Maranhão	374,977	1,176,329	3,137
Jalapão/Tocantins	164,174	534,619	3,256
Santa Maria da Vitória/Bahia	326,138	1,076,640	3,301
Alto Parnaíba Piauiense/Piauí	340,420	1,129,232	3,305
Rio Formoso/Tocantins	120,547	447,093	3,709
Barreiras/Bahia	1,341,441	5,124,496	3,820
Total	**3,271,338**	**11,217,911**	**3,429**



Source: Gite-Embrapa.

Minister of Agriculture Katia Abreu has launched a program to link the producing regions of Matopiba to the ports and consumer regions and reduce the cost of transporting crops to market.

Northeast (27,300 km) as in fair, poor or very poor condition. In the states in the Matopiba region, CNT classified 79% of the roads as fair, poor or very poor condition. In the agricultural sector, according to Embrapa and the National Water Agency (ANA) there are several works in progress or scheduled. In 2013, there were 1,544 irrigation pivots in the region, covering an area of 150,200 hectares. They also found 870 warehouses with a total storage capacity of 7.8 million metric tons.

Poor socioeconomic conditions in Matopiba are the greatest problem, according to Alves and Souza, the Embrapa researches. Rocha and Lopes note that the educational situation in the municipalities of Matopiba region, according to the 2010 Census, is very precarious. In 39% of the municipalities in the region a quarter of the population aged 15 or more cannot read or write. Rocha and Lopes point out that there is a lack of public policies to eliminate poverty and support a more balanced development in Matopiba. They deem important the initiative of the Minister Katia Abreu to create a development agency for the region, but they say this agency will only be effective if it gives priority to inclusive growth.

The first step to develop Matopiba, Miranda believes, is to be aware it will not be a simple job. He points out that "the poverty situation in Matopiba is not caused by the recent development of agriculture. Poverty already existed." Miranda also believes it is important to acknowledge that there are general policies, such as paving roads, which benefit everyone, although specific polices are necessary in Matopiba.

The work, in his opinion, should start by identifying a number of subregions where intensification of agriculture is promising; identifying small farmers who should adopt technology, and improving the access of farmers to technology and credit. At the same time, farmers associations should be created so they can buy their inputs and sell their products better.

Other important points highlighted by the Gite-Embrapa study are the vertical integration of production, providing conditions for the emergence of production chains. Miranda also emphasizes integration activities. In irrigated areas, for example, there should be encouragement for fish and shrimp farming. Miranda points out that today cities like Belém and Marabá, in Pará state, are supplied with fish coming from Vietnam.

The service sector starts to topple



Cristina Alves

THE SERVICE SECTOR—the engine of the Brazilian economy, accounting for almost 70% of GDP—is already feeling the effects of household budget tightening and government spending cuts. After the steep downturn for industry after the financial crisis, "The cyclical downturn of the service sector has started," says Vinícius Botelho, IBRE researcher. The result is already being seen in lower sales and job cuts.

Job losses

Silvia Matos, technical coordinator of the IBRE Macro Bulletin, believes that though losses of formal service jobs are likely to be compensated in part by informal jobs, nevertheless job insecurity will increase. Concern is therefore justified because services and commerce account for two-thirds of jobs in Brazil, employing more than 60 million people.

The job cuts have already begun. The General Registry of Employment and Unemployment for May shows a loss of 32,602 formal services jobs. The services job cuts are second only to those of industry (60,989). All in all, Brazil lost 115,599 formal jobs in May.

Not unrelated, there has also been a significant decrease in services sales. In the year through April, according to the latest Monthly Survey of Services by government statistics agency IBGE, income for the services sector grew by only 2.6%, down from 8% in the same period in 2014.

Inflation

Services inflation, however, is growing: through April the 12-month rate was 8.3%. General services such as rentals, hotels, recreation, telecommunications, health plans, doctors and dentists, insurance, banking,

Reduction of Brazilians' purchasing power —real income decreased 3.8% in the period—has had a decisive effect on the reduction in services output.

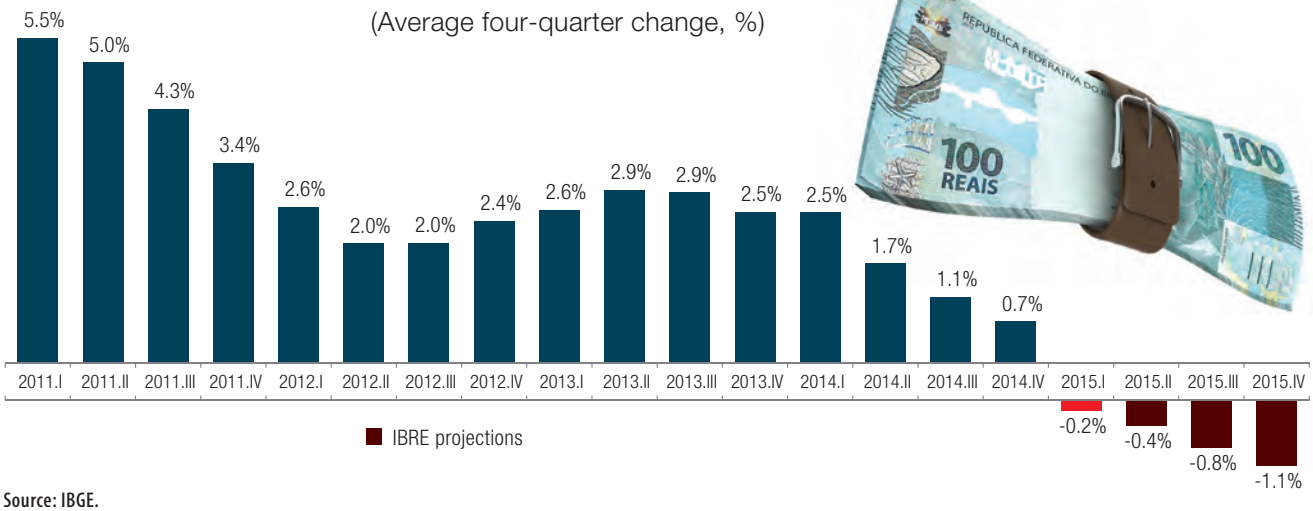
education and transportation (excluding air tickets) accounted for 19.27% of the official consumer price index, followed by eating out (8.75%), and labor-intensive services, such as accountancy and household repairs (7.2%). Together, services account for over one-third of Brazil's inflation. "If domestic demand was not constrained, services inflation would be in the double digits," Matos says. Indeed, to prevent further decline in demand, so far businesses have not passed their cost increases through to consumers.

Adjustments in households spending are helping to contain inflation. For instance, families are eating out less. Eating out-related services inflation was 5.99% in the first half of this year, slightly higher than 5.6% in the same period of 2014. In labor-intensive services inflation was 4.63% in the first half of the year, down from 5.11% in the same period last year. "Many service providers, from doctors to handymen, have not raised their prices in order not to lose customers," Matos says. Finally, general services inflation was 4.92% in the first half of this year, up from 4.88% in the first half of 2014. Inflation in this category has been kept down by declines in some prices, such as rent, in recent months.

IBRE forecasts that this year services inflation will be about 8% this year and headline inflation between 8.8% and 9%; next year the forecast is for about 7% and headline inflation between 5% and 5.5%.

Services GDP in free fall

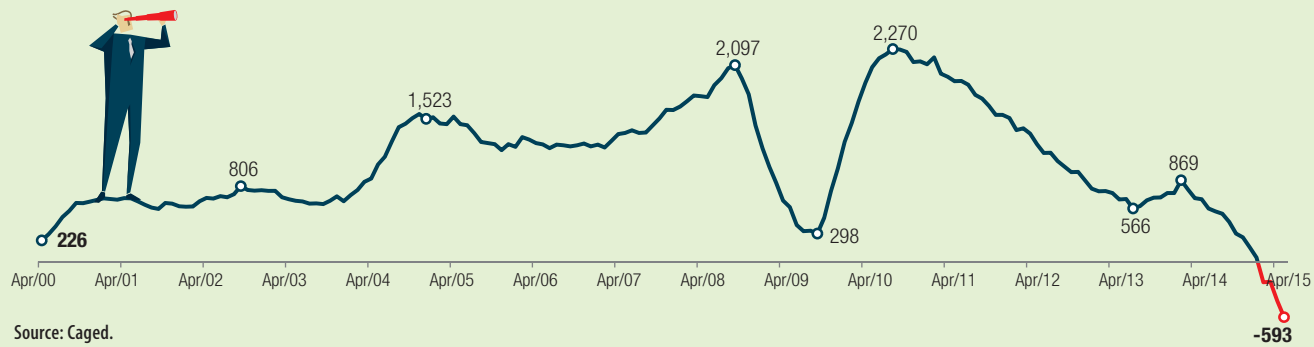
(Average four-quarter change, %)



Source: IBGE.

Employment in services is declining

(Hirings less firing, in thousands of employees, 12-month average)



Source: Caged.

"Government expansionary policies after 2010 have been reversed. We also have rising interest rates, administered price adjustments, and fiscal tightening," says Vinicius Botelho, IBRE researcher. The Brazilian economy is thus likely to continue contracting, with a negative effect on services.

Cutting spending

The IBGE survey shows services provided to households went up by 1.2% year-on-year in April. This is significantly lower than what was recorded for March (2.5%) and February (6.8%). According to IBGE, reduction of Brazilians' purchasing power—real income decreased 3.8% in the period—has had a decisive effect on the reduction in services output.

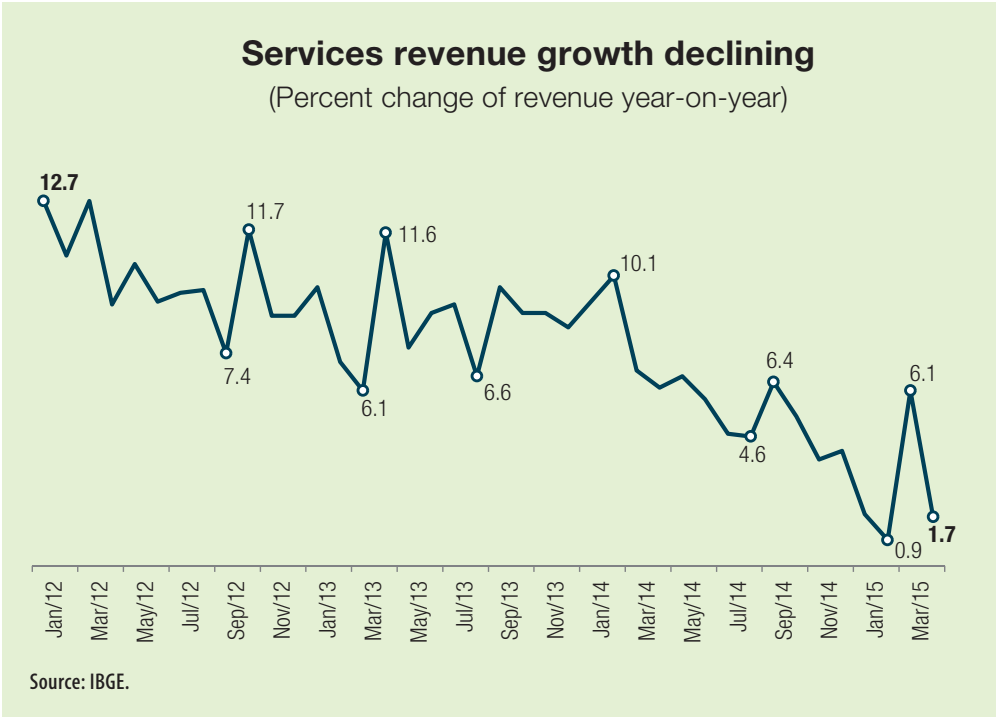
Economist Fernando Ribeiro, Institute of Applied Economic Research, see the service sector suffering from the effects of the fiscal adjustment promoted by the government, inflationary pressure limiting consumer spending, and higher energy costs.

Antonio Corrêa de Lacerda, partner of Macrosector Consultants, believes services sector recovery will come only at the end of 2016 or early 2017. Until then, the services sector is likely to continue cutting jobs, depressing further the economy.

"The slowdown is general, across all services sectors…. Consumers have hit the

"Even those who continue eating out have cut spending on meals, and we are also suffering from the downturn in tourism as well as rising unemployment."

Darcilio Junqueira



brakes," says Christian Travassos, economy manager of the Federation of Commerce of Rio de Janeiro State, which represents 348,000 establishments offering goods, tourism, and other services in that state. High inflation, high interest rates, and unemployment have been hard for commerce and the services sector, he says.

"The slowdown is general, in all services sectors…. Consumers have hit the brakes."

Christian Travassos

Darcilio Junqueira, superintendent of the Union of Hotels, Bars and Restaurants of Rio de Janeiro, confirms that the services sector is suffering from the effects of the economic downturn and suggests the situation is particularly serious in Rio: "Investigations of corruption at Petrobras and the company's cuts in investments have hit many suppliers, which has suppressed commerce and services." He says that eating out was one of the hardest-hit areas: "Even those who continue eating out have cut spending on meals, and we are also suffering from the downturn in tourism as well as rising unemployment." Junqueira calculates that turnover in Rio's service sector is down 10% compared to 2014.


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How should state-owned enterprises be governed?

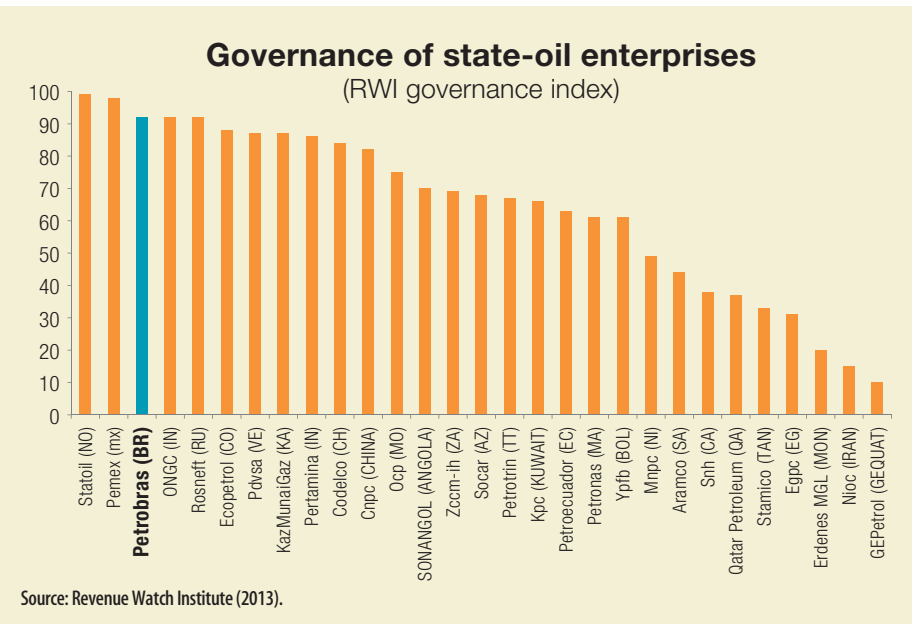
Sebastian Azumendi
Researcher, FGV Center on Regulation and Infrastructure

THE CRISIS AT THE STATE OIL company, Petrobras, has sparked a passionate debate on the role of state-owned enterprises (SOEs) in the economy. Since March 2014, the country has been discussing what should be done with Brazil's largest company. So far the debate has been mainly motivated by ideology (public versus private ownership) and politics; there has been little attempt at diagnosis, much less solutions.

Did the Petrobras crisis result from a lack of management transparency? How have sectoral and macroeconomic policies (e.g., tariff-setting for the energy sector) affected company performance? Has Petrobras followed good corporate governance practices? How effective are Brazil's good governance policies for SOEs and what are good international practices? Ultimately, the design of effective policies for the SOEs will depend on the accuracy of the diagnosis.

Before the current crisis, Petrobras was thought to be in compliance with international standards for corporate governance. Since it entered the international capital markets in 2000, the company has followed the corporate governance rules of the New York Stock Exchange. According to the Revenue Watch Institute (RWI), in 2013 Brazil was among the countries where transparency and accountability in the oil and gas sector were good; that year Petrobras ranked among the top three state oil companies for transparency and accountability best practices. Few SOEs met such qualifications.

On the face of it, Petrobras governance seemed to be good in terms of international governance standards and transparency in the management of natural resources. However, recent events have exposed significant flaws in both internal and external management controls.



Source: Revenue Watch Institute (2013).

And if RWI's assessments are analyzed in more depth, it can be concluded that internal controls were ineffective and that the measurement of governance took into account only formal aspects rather than what the company was doing in practice. For instance, with regard to the rules of the New York Stock Exchange, the differences between the governance of U.S. companies and that of Petrobras are significant: as a foreign company, Petrobras has to comply with only minimum standards of transparency.

Perhaps the most important difference is that the directors of Petrobras are not independent. This in practice is critical for professional management, especially of SOEs. In Brazil, Petrobras has never adhered fully to the standards of good corporate governance of the São Paulo Stock Exchange (Bovespa), complying only with the minimum standards for a stock exchange listing. In contrast, other Brazilian SOEs, such as electric utility Eletrobras, adhere to Bovespa's highest standards for good governance.

RWI's measurement of good governance is essentially formal, rather than objectively evaluating the company's operation controls in practice. For instance, in the RWI 2011 report, Petrobras was positioned well above half of the largest world oil companies, public and private, in terms of information on instruments against corruption. Yet Petrobras approved its first Corruption Prevention Program only in November 2013.

It would be desirable for Petrobras and other Brazilian SOEs tackle their governance problems more effectively, as SOEs elsewhere have done. For instance, Chile's Codelco, the National Copper Corporation that is the world's largest copper company, changed the composition of its Board of Directors so that a majority of members are appointed by the High Council of Public Management—a body of public administration responsible for the appointment of high-level government employees. At least 40% of the directors of Colombia's Electric Interconnection Corporation (ISA) must be independent; in practice, the majority of its directors are.

On the face of it, Petrobras governance seemed to be good in terms of international governance standards and transparency in the management of natural resources. However, recent events have exposed significant flaws in both internal and external management controls.

Ultimately, governance of SOEs should respond to the real needs for transparency and good management in the context of their own operations. An effective system of governance must take into account the good management practices of both the private and the public sector. It would be desirable to consider how best to involve such government agencies as the Court of Auditors and the Comptroller General, in SOE audit systems to ensure their accountability.

Public policy intended to build up SOE governance and management should require the highest levels of financial and nonfinancial transparency, attract professional and independent directors and executives, grant the Court of Auditors power to control and evaluate SOEs, establish effective mechanisms for evaluating the performance of directors and executives, and give private shareholders guarantees that the company complies with high standards of corporate governance.

BRICS and the pursuit of growth

An FGV seminar assesses cooperation between BRICS countries as they all pursue sustainable growth.



Solange Monteiro

SINCE ITS FORMAL ESTABLISHMENT IN 2009, the BRICS group has provoked controversy about how valid it is as a bloc. Size—28% of world GDP and 42% of world population—does not seem sufficient to unite countries with such different realities and challenges, especially economic. In early June, the FGV Growth and Development Center convened a group of international experts to discuss the growth issues of the BRICS and the possibilities for their cooperation.

"The BRICS are identified more as a political bloc than an economic one, but what interests us are the factors that generate wealth in some countries to the detriment of others," said Pedro Cavalcanti, of FGV Growth and Development. One study by the center's Roberto Castello Branco, João Victor Issler, and Bruno Delalibera found a connection that integrates the BRICS economies despite their apparent differences. The study found that to a greater or lesser extent, BRICS countries have common growth cycles, which suggest that the dynamics of each member can affect other members of the bloc more than growth in developed economies. Since the members consist of three major suppliers of commodities (Brazil, Russia, and South Africa) and two major consumers of commodities (India and China), that result seems logical. Quarterly GDP (excluding India) shows that the strongest interactions are between Brazil and China, China and South Africa, and Brazil and Russia.

"Besides trade, the BRICS do share factors and challenges common to emerging economies, but they also have very big differences," Castello Branco noted. Among the differences is degree of urbanization: in Brazil 85% of the population lives in cities, in China 54%, and in India 32%. Raising productivity is a challenge for economies that have a large service sector, such as Brazil and South Africa, while adding value to its manufactures is a particular challenge for China. Demographic differences are also great. The large share of the young in the populations of India and South Africa (the demographic bonus) will generate growth by 2040, while China and Brazil are already worried at seeing their own demographic bonuses tapering off. Castello Branco points out that a number of policies would serve more than one country in the bloc, such as improving worker skills, investing in infrastructure, reforming the financial system, and fighting corruption. In his opinion, "The performance of the BRICS will depend largely on how they face these challenges."

Differences and affinities

In the short term, the BRICS countries that have the best growth prospects are those that are further ahead in reforming their economies: even slowing down, China is expected to grow 7% in 2015, and India should lead the global expansion with 7.5% in 2015, according to the International Monetary Fund. In contrast, Brazil and Russia are expected to contract

"The BRICS are identified more as a political bloc than an economic one, but what interests us are the factors that generate wealth in some countries to the detriment of others."

Pedro Cavalcanti

by 1.8% (IBRE staff estimation) and 3.5%. In the case of India, Eswar Prasad, professor at Cornell University and a research associate at FGV Growth and Development Center, pointed out that controlling inflation was the mantra for the economic reforms that began in 2008, well before Prime Minister Narendra Modi was elected, and consolidated the way for new reforms. "This resulted in building trust, which helped the policy agenda of the new government," he said. The fall in oil prices, which India must import, helped to push inflation down and reduce the pressure on the budget, which has brightened the fiscal outlook.

Although the reforms so far have put India in the spotlight, they are not sufficient to ensure optimism about the long run, Prasad said. For India, he believes that the dynamics of the service sector that has boosted exports has inhibited development of the domestic market, a weak aspect of India's economy.

To a greater or lesser extent, BRICS countries have common growth cycles, which suggest that the dynamics of each member can affect other members of the bloc more than growth in developed economies.

"You cannot create job opportunities with good salaries to support the increase of domestic demand without developing the manufacturing sector," Prasad said. To promote industry, he believes conditions in India are still unattractive. "Infrastructure is a problem: transport infrastructure is not in good shape, and the financial system does not work well. India still has a long list of reforms that will take time," he says. Like Brazil, India needs to improve its business environment, fight costly bureaucracy and inflexible labor laws, and broaden financial system reform. "We have a high level of savings, 35% of GDP. But it is concentrated in families, and today the financial system does not have the capacity to intermediate household savings and foreign capital to fund long-term fixed investment," he said, pointing out that this blocks investment in infrastructure. "We need to take advantage of the favorable domestic and external situation to further reform. We have the cards to have growth. What's on the table now is whether we will be able to play well or create more problems for ourselves," he says.

Infrastructure is also a constraint to attracting productive investments in South Africa, says Jean-François Brun, lecturer at the Université d'Auvergne and also a research associate at FGV Growth and Development Center. "South Africa has low-quality infrastructure in telecoms and transportation, and a major energy deficit," Brun said—a situation that is common in Sub-Saharan Africa as a whole and may jeopardize sustainable growth. "The continent is rapidly changing thanks to the exploitation of natural resources," he said. "As a result, Kenya, Ghana, and Senegal can turn very quickly into emerging economies, growing 6%, 7%, and more. This has helped South Africa," he said. "On the other hand, the high share of natural resources, which accounts for 30% to 50% of the expansion of African countries, is also a vulnerability factor for the region." The growth of South Africa's GDP predicted for 2015 is a moderate 2%. South Africa does have a more diversified economy, a consolidated banking system, and a sound fiscal policy. Although a value-added tax (VAT) was introduced in the late 1980s, Brun pointed out that the country's low institutional capacity prevents the improvement in fiscal stance that VAT would allow. "The bureaucracy does not perform well. The VAT has become inefficient because numerous exemptions have generated distortions and prevent public spending from growing."

With regard to China, seminar participants highlighted the potential of the reforms President Xi Jiping is carrying out. Domestically, Castello Branco emphasized tax reform in China's provinces, the reduction of shadow banking, and the opening of services to the private sector as important measures to boost and diversify the economy and stimulate domestic consumption. Jonathan Fenby, a partner at Trusted Sources consultancy, pointed out the importance of the anticorruption campaign to improve the efficiency of the Communist Party itself.

With an excess of productive capacity, savings amounting to 48% of GDP, and US$4 trillion in international reserves, China has opened important fronts abroad. It is participating in the construction of routes for importing supplies and exporting its production through railways, pipelines, and the new Silk Road, which will cross Central Asia. With the gradual opening of the capital account, China aims to internationalize its currency, the renminbi. And with the creation of the Bank of the Brics and the Asian Development Bank, it is creating alternatives for international financing of projects of strategic interest in its own vicinity and in Latin America. "Tokyo, Washington, and Manila are concerned about a possible regional risk," Fenby said, warning that "it will be necessary to observe developments in East Asia and consider possible tensions with Taiwan in 2016."

Yao Yang of the Peking University Center for Economic Research and associate professor of FGV Growth and Development Center was straightforward about China's ambitions. He said that the measures China has adopted to maintain 7% growth over the next 10 years will demonstrate the same resilience that Japan and South Korea had in the oil crisis of the 1970s and the Asian crisis in the 1990s. "China will be the largest economy in the world in 2020–25, and China, Japan, and Korea will account for 50% of world demand in 2040–50, creating a big market for the world," he predicted.

The large share of the young in the populations of India and South Africa (the demographic bonus) will generate growth by 2040, while China and Brazil are already worried at seeing their own demographic bonuses tapering off.

Brazil and the new China

For now, China's gradual slowing down and rebalancing of its economy toward more domestic consumption highlights the need for Brazil to become more competitive to match China's trade dynamism. Generally speaking, China's changes should encourage Brazil to rely less on exporting commodities. While in 2002 soybeans, iron ore, and oil accounted

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for 57% of Brazil's exports to China, by 2014 the three products accounted for 80%. "The increase in the share of personal consumption in China's GDP poses a challenge for Brazil to diversify its exports and seek to participate in supply chains and the export of services," said IBRE's Lia Valls Pereira.

Murilo Ferreira, CEO of steel company Vale, noted that part of the Chinese government's efforts to prevent further slowdown of the economy is to continue to stimulate infrastructure and real estate investment by encouraging formation of public-private partnerships (PPPs) and reducing the cost of mortgages. Even with these initiatives, however, decline in demand for mineral commodities is inevitable. Vale projected annual growth of iron ore exports to China of just 1.2% in 2015–20, compared with 20.4% in the last 15 years. This fall in Chinese demand for commodities is a concern for the rest of the world as well as Brazil. "In 2014, China accounted for 58% of world demand for iron ore," Ferreira said. Last year, China accounted for 18% of Brazil's total exports, of which iron ore accounted for 5.5%.

Mauricio Mesquita Moreira, chief economist at the Inter-American Development Bank, also advocated that Brazil diversify exports and add value to its exports to China. "The worst of all worlds is one in which the government does not eliminate trade barriers for fear of deindustrialization and the private sector does not fight for access to markets, remaining focused on the domestic sector," he said. Moreira noted that the speed at which Chinese exports have diversified has affected Latin America as a whole: "From 2002 to 2014, Venezuela, Chile, Brazil, and Peru recorded a trade surplus with China thanks to high commodity prices, but on average Latin America had a negative trade balance." He also pointed out the need to attract Chinese direct investment, which is expected to increase in some South American countries. In May, during the visit of Chinese Prime Minister Li Keqiang to Brazil, the two countries signed 35 agreements involving US$53 billion as part of the US$250 billion that China plans to invest in Latin America in the next 10 years. "So far, Chinese investment often has reinforced the pattern of bilateral trade we already have, without stimulating product diversification in

Brazil," Moreira said, noting that from 2000 to 2014, Chinese direct investment in the region focused on energy (57%) and metals (34%), and the main recipients of Chinese investment were Brazil (38.4%) and Peru (31.9%). Chinese lending followed the same pattern. According to the Inter-American Dialogue, of the US$199 billion China has announced to finance Latin American governments and companies from 2005 to 2014, US$50 billion went to infrastructure projects and US$33 billion to energy. "We have to improve our macro and fiscal position and be pragmatic in our trade policy. We need to foster South-South cooperation, avoiding the creation of financial dependency on China. The focus should be trade, not aid, in the pursuit of sustainable growth," Moreira emphasized.

The challenges of China's transition were also the subject of discussions at an IBRE workshop last June for a Chinese delegation led by Yang Zhenwu, president of the *People's Daily* newspaper. At the time, Zhenwu underlined the opportunities of the new Chinese growth path: "Accelerating urbanization will mean a demand for commodities with higher added value, which Brazil can exploit. … We also see the change in China's policy to attract foreign capital to be beneficial as it would give Brazil the opportunity to make new investments in China." At the time, IBRE's Pereira stressed

"China will be the largest economy in the world in 2020–25, and China, Japan, and Korea will account for 50% of world demand in 2040–50, creating a big market for the world."

Yao Yang

that there is always a dichotomy between opportunities and challenges in the relationship between the two countries. "On the one hand," she said, "Chinese demand contributed to the growth of the Brazilian economy and mitigated the effects of the international financial crisis; on the other hand, competition from Chinese products has caused Brazilian products to lose market share in the U.S. and South America as well as in Brazil's domestic market." Pereira pointed out, however, that Brazil's lack of competitiveness cannot be attributed to China: "We have structural issues, such as low investment and a poor business environment, as well as a fiscal deficit and inflation that we have to resolve." To make Brazil grow, there is no alternative to putting its house in order and focusing on opportunities.

Photo: Release



"Our laws and bureaucracy do not encourage productivity"

Luiza Helena Trajano

President of Magazine Luiza and the Institute for Retail Development (IDV)

Solange Monteiro

Luiza Helena Trajano is known for being active and optimistic, and this is reflected in her company's performance. In the last five years, Magazine Luiza, a chain of retail stores, has more than doubled its turnover: In 2014 alone, the company served 39 million customers and grossed R$12 billion, mostly generated in 647 stores in four regions of the country. Today, however, she worries about low consumer confidence. "We will have to work to lower costs, increase productivity, and think out of the box to attract consumers into the store," she says. She is a member of the Council for Economic and Social Development (CDES) and Chairperson of the Board of the Organizing Committee of the Olympic Games Rio 2016. She advocates increasing the country's productivity, but disagrees with the view that labor is expensive. "What's added to wages makes labor more expensive," she says.

***The Brazilian Economy*—Late last year you predicted 2015 would not be so bad. What is your view now, considering that first quarter net profit of your company fell more than 80% over the same period of 2014?**

Luiza Helena Trajano —I thought the first half of 2015 was going to be like that. The default, in our area, is under control. It has not increased. What worries me is consumer confidence, which is at its historical lowest. Consumers are

What worries me is consumer confidence, which is at its historical lowest. Consumers are concerned about so much negative news, high inflation, and losing their jobs. And when consumers lose confidence, they stop buying.

concerned about so much negative news, high inflation, and losing their jobs. And when consumers lose confidence, they stop buying. There are different segments in retail. For confectionaries, it was not so bad. For us, the first quarter of 2015 was worse than last year because then the World Cup boosted sales. In the first quarter of 2014, Magazine Luiza had net profits 25 times higher than the same period of 2013, reaching R$20.5 million. We have seen a drop since July of last year, but I think sales will be better after July this year. Although we have an economic crisis, what is most worrying today is the political crisis that delays approval of necessary reforms. Now is the time for a reality check. It's not about being optimistic but about seeking alternatives.

For retail, what are the alternatives?

The retail challenge is to lower labor costs, increase productivity, and overcome the difficulties of the moment, especially low consumer confidence, which pulls down everything else. And think out of the box to attract consumers into the store. In the case of *Magazine Luiza,* we are in the media and continue doing raffles for loyal customers—this year the prize will be a condo.

Credit restraint is also important to a luxury segment like yours, is it not?

Banks had tightened credit before loan defaults increased … and people who have recently earned the right to credit do not want to lose it. But the credit restriction does not hurt as much as low consumer confidence.

Does the company's customer relationship management help to mitigate the uncertainty?

Our customer relationship management is one-to-one. Three to four times a year, we open all the shops on Sunday for loyal customers only. We have direct mail adjusted to what each customer buys, where we make recommendations …. We offer breakfast, and in one day we sell the equivalent of a week's sales.

Since the middle of last year it has become more evident that consumption-led growth has run out ....

I do not agree. In Brazil, only a small part of the population has flat screen TV. Only 54% have automatic washing machine. We need to build 23 million homes in 10 years to achieve the social equality of a developed country. Brazil has potential. What is questionable are

Although we have an economic crisis, what is most worrying today is the political crisis that delays approval of necessary reforms. Now is the time for a reality check.

the incentives to [promote growth] … What would justify saying that consumption-led growth is over? We would have to prove that the market is saturated. But only 12% of people have notebooks. Although Brazil is the country with one of the largest mobile phone rates, only half the people have smartphones. So how is the consumption exhausted if so many investors want to come here because of the potential consumption market? But to continue growing requires high consumer confidence, employment, income and credit.

It is said that growth has flattened, among other reasons, because of the imbalance of increased labor cost relative to productivity. Do you disagree?

To produce more requires increased productivity. ... You cannot improve productivity without aiming to increase revenues. In our company, we grew and then reorganized, grew again, and reorganized. Without growth it is difficult to manage focusing on productivity.

… It's the same for Brazil. Brazil grew, and now we have to focus on productivity.

Labor is expensive, and this penalizes the service sector as it is a major employer. How do you manage this issue in your company?

Brazil has to be careful not to turn into a China where the worker earns very little. I believe that what makes labor expensive are the bureaucratic costs and payroll taxes. Here at Magazine Luiza employees earn according to their sales. But Brazilian laws are not flexible. For example, employees cannot work after six in the evening … Our laws and bureaucracy do not encourage productivity … I do not think labor is expensive. … I believe the country has to have more social equality and pay better salaries. How we do this is arguable. We have to modernize how we deal with unions just like Germany, which led a modernization of capital and labor relations.

But productivity also implies efficiency.

Sometimes one does not invest in productivity because everything is very expensive and difficult. For example, we give an allowance to women employees who have a child, but this allowance is taxed. We give scholarships to help our staff, and these also are taxed. Opening our shops on Sundays to our loyal customers generates a large turnover, but most unions oppose it even though the employees themselves want the shops open so they can earn more. It is simplistic to analyze just productivity in terms of level of education, but it is not only that … If these

barriers to business are not eliminated; we won't be able to increase productivity. You're too tied up to teach, educate, or do anything because of old laws and old unions.

What can we do to improve this situation?

All companies should be free to negotiate with their employees. In Germany, labor law requires companies to consult and collaborate with workers in works council (*Betriebsrat*). We could give each one what is fair, even if it is different, and do not have a law that says that on Sundays I have to pay R$100 for everyone, regardless of the commission, which increases costs and underestimates the ability of workers to negotiate. … Our company has had works councils for over 15 years. Council members are elected by employees and cannot have management positions. The objective is to protect employees, whether for health insurance adjustment or food tickets. But to no avail, we still need to negotiate with the unions in each city to open our shops on Sundays.

Does the labor bill that extends outsourcing to core activities of the companies address the issue?

It is positive to formalize something that is informal. Now you need to be very careful, because it will not change much. Our company does not like outsourcing, because it limits our contact to employees. Also, I think 2 to 3% of our company bottom line is going to no one but Brazil's bureaucracy. ... I'm supporting a drive for less bureaucracy for small businesses led by Guilherme Afif Domingos, Minister for

Brazil has to be careful not to turn into a China where the worker earns very little.

Micro and Small Enterprises, but it should be extended to large businesses. Today it takes twice as long to close a business than to open due to red tape. We are in the digital age, and the country needs to wake up.

Your company has been recognized as a model for personnel management. How do you deal with the low skills of workers?

We give our employees scholarships to study any subject, as the scholarship is not intended to keep employees in the company. The person may study history and be out of here the next day … We also have with the Getulio Vargas Foundation an online course in leadership. So for us to help Brazil's education is to facilitate access to education. Because our employees do not have money to get into a private college and as they work all day they have more difficulty in getting to a free public college.

What should be done for a qualitative leap in public education?

There are many good initiatives, but they are all dispersed. I lead a non-partisan group called Women of Brazil. … When we researched education, we saw that many people are doing a lot, but all very dispersed. If everyone unites around one education project for the next 20 years, we would not have to do much. Among the noteworthy initiatives are full-time

schooling, and separating state, municipality, and federal schooling responsibilities. Each government level should not interfere with the others, as happens today. … I say that without making reforms in this country, nothing will go forward. Politicians are elected within a backdrop. How can they fight for something if they are elected the way they are? But change has to be born out of society.

Your company has declared a focus on the middle class. With the fall in labor income and rising unemployment, how do you expect the country to maintain its social inclusion achievements and the expansion of middle class consumption?

We have lost some purchasing power, but people are not the same. Of course there may be job losses, but I think they will not be enough to jeopardize the achievement. Now, how we raise from poverty the other 19 million Brazilians who earn less than R$70 a month remains a challenge.

Recently you said Brazilian retail needs to take a new leap as has happened in the U.S. What do you mean?

Ten years ago, when we set up the Institute for Retail Development (IDV), neither retail nor services had a department within the Ministry of Development. By their lack of unity and lack of focus, retailers did not participate in anything; they had no political influence at all. When IDV joined other representative retail bodies, we realized that the retail sector was the largest employer in Brazil after the government; our union strengthened us. Today, we are invited to discuss decisions and we participate more. Now we have to take another leap. If we are a large sector, we have to assume this role and contribute to the country's development. Imagine the influence we will have if we unite all retail associations as the National Retail Federation in the U.S. does.

Brazil will benefit from the Olympics. We are carrying out a marketing strategy so that people will know how much it costs with total transparency as well as how the country will benefit from the Olympics.

Among many activities, you also chair the board of the 2016 Olympic Games in Rio de Janeiro. What is your role?

Two years ago, President Rousseff decided to establish strong governance for the Olympic Games. She wanted to have a woman on the board, and called me. The board oversees all the organization of the games. There are many details, and I'm learning and helping a lot. … The event will leave a great legacy for Rio. … I'm sure Rio de Janeiro will be a different city after the Olympics, as occurred with Barcelona. Brazil will benefit from the Olympics. We are carrying out a marketing strategy, so that people will know how much it costs with total transparency as well as how the country will benefit from the Olympics.