Fiscal policy
How long will fiscal discipline last?

Seminar
The problem of managing natural resource revenues

Interview
Amos Genish
President of Vivo



THE BRAZILIAN ECONOMY

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Finding the right balance for financing the economy

Brazil's current account deficit is narrowing—but how much longer will the world be willing to finance it?

FGV IBRE

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Photo: Wilson Dias. Agência Brasil

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It has been 15 years since the Fiscal Responsibility Law was passed, and it has been fairly successful in promoting better fiscal management by states and municipalities. However, Solange Monteiro reports, it has never set limits for federal government debt, and today recession and falling government revenues are putting the law to the test everywhere.

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From the Editors

DESPITE THE SEEMINGLY never-ending flow of bad news for the Brazilian economy, occasionally some has been good. For instance, the external current account balance, which had been deteriorating since 2010, this year has improved. For an economy apparently in free-fall, the current account deficit of US$104.9 billion at the end of last year was alarming, raising questions about Brazil's external vulnerability in 2015. But the steep drop in economic activity has helped to reverse the widening deficit. Our cover story looks into how large an external current account deficit is consistent with sustainable growth.

But if the external accounts have improved, internally industry is having one of its worst crises in years, causing falling retail sales and rising unemployment. So far this year industrial production has already fallen by 6.3%—its sixth decline in eight months; Brazilian industrial production is being beaten down by double-digit interest rates, low consumer confidence, and steep cuts in government investment.

Nevertheless, Amos Genish, President of Vivo, is still optimistic about the Brazilian economy. Despite its current difficulties, he believes that globally Brazil is one of the countries that offer the best business opportunities in all segments. But he warns that the fiscal adjustment should concentrate on cutting public spending rather than raising the already high tax burden, which has been inhibiting investment and could harm the poorest Brazilians.

A necessary condition for sustainable growth is that government save enough to pay down its debt and reduce interest rates. However, with tax revenues falling, the current economic downturn makes it much harder to meet the fiscal primary surplus target, which was cut in July from 1.1% of GDP to 0.15%. In these circumstances, raising the tax burden would not only inhibit investment but also deepen the downturn. A successful pro-growth fiscal adjustment critically depends on controlling current spending over the long term. The 15-year-old Fiscal Responsibility Law (FRL) provides the framework for more transparent and accountable public spending, but it sets debt and spending limits only for states and municipalities, leaving the federal government to spend at will. This far-from-ideal situation needs to be corrected.



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ECONOMY

External deficits narrows in June

Brazil posted an external current account deficit of US$2.5 billion in June, down from US$3.4 billion in May. In the 12 months through June, the current account deficit was 4.4% of GDP. A weaker Brazilian currency is helping exporters and lowering demand for imports. Brazil attracted US$5.397 billion in foreign direct investments last month. (July 22)

Unemployment up in June

Unemployment rose to 6.9% in June, from 6.7% in May, government statistics agency IBGE said. The jobless rate rose mostly because employment fell by 1.3% year-on-year. Surprisingly, however, real wages increased 1.5% month-on-month, though that is not likely to continue. (July 23)

Consumer confidence at a record low

The Consumer Confidence Index, calculated by FGV's Brazilian Institute of Economics (FGV/IBRE), in July fell to 82 points, its lowest level ever. The decline reflects both dissatisfaction and pessimism about the economy and a deterioration of household financial situations. (July 24)

Inflation soars in July

In July Brazil's 12-month inflation rate rose to 9.56% year-on-year, its highest point since November 2003, according to statistics agency IBGE, as electricity rates continued to shoot up and the exchange rate depreciated. The benchmark IPCA index rose 0.62% for the month, though that was less than the 0.79% rise in June. Government-regulated prices went up not only for electricity but also for health insurance and interstate bus fares. (August 7)

POLITICS

Lula investigated for influence peddling

Federal prosecutors in Brazil have announced a probe into possible influence-peddling by former president Lula da Silva (Worker's Party) that involves the construction firm Odebrecht, one of Latin America's largest engineering companies. The investigation centers on Lula's alleged use of his clout after leaving office to help Odebrecht land billion-dollar contracts in Cuba, the Dominican Republic, Ghana, and Venezuela. He is also alleged to have helped persuade the Brazilian national development bank, BNDES, to finance the foreign projects. (July 17)



Photo: Marcelo Camargo Agencia Brasil.

House Speaker Eduardo Cunha breaks with the government.

Lower house speaker accuses government

House Speaker Eduardo Cunha has accused President Rousseff's government and prosecutor general Rodrigo Janot of conspiring to incriminate him in a corruption scandal at state-run oil firm Petrobras, in which it is alleged that he took bribes. Cunha said he would push to remove his Brazilian Democratic Movement Party (PMDB) from the governing coalition at its congress in September. Rousseff responded at a conference of her regional peers by saying that in South America there is no room for "anti-democratic adventures". Some opposition lawmakers are calling for Rousseff's impeachment; Cunha as speaker would be responsible for initiating the process, which her allies are calling a potential coup. (July 17)

President's popularity sinks in political and economic crisis

Pollster Datafolha said Rousseff's approval rating has fallen to 8%, close to the 7.7% reported in another recent survey. The number of Brazilians that consider her administration "bad" or "very bad" touched 71%, up from 65% in the previous Datafolha poll in June. Two in every three respondents, 66%, said Rousseff should face an impeachment process, up from 63% in an April poll. (August 6)



Photo: Wilson Dias/Agencia Brasil

Hard times for President Rousseff.

INTERNATIONAL

BRICS vow to coordinate economic actions

Russian President Vladimir Putin hosted a summit of the BRICS group of emerging nations in the Siberian city of Ufa and met individually with Brazil's president Rousseff, Xi Jinping, president of China, Jacob Zuma, president of South Africa, and Narendra Modi, prime minister of India. The group expressed their concerns about the volatility of global financial markets and oil prices and agreed to coordinate efforts to keep their economies stable. The BRICS launched the group's largest initiatives to date—a development bank and a currency pool. It has taken more than three years to resolve funding, headquarters, and personnel issues for the new development bank, which will have US$50 billion in starting capital and expects to begin lending in 2016, primarily for infrastructure projects. (July 9)

ECONOMIC POLICY

Fiscal surplus target slashed

As tax revenues plunge, Brazil's government has drastically cut its fiscal savings goals for 2015 and 2016 and announced more spending cuts to underscore its commitment to austerity given the steep economic downturn. The 2015 primary surplus goal was dropped from the budgeted R$66.3 billion (equal to 1.1% of GDP) to R$8.7 billion (0.1% of GDP). This fiscal indicator is closely watched by markets and credit rating agencies to estimate government's capacity to repay its debt. The cuts to the primary surplus targets could complicate President Rousseff's bid to regain the confidence of investors as the economy heads into its worst recession in 25 years. (July 22)

S&P warns of a possible ratings cut for Brazil

Brazil could lose its coveted investment-grade rating from Standard & Poor's if there is fallout from corruption investigations and austerity measures prove inadequate. S&P affirmed Brazil's credit rating of BBB-minus, its lowest investment grade rating, but revised the outlook on that rating from stable to negative, signaling a downgrade is possible in the next 12 to 18 months. S&P stated that in its opinion "the policy correction will face further slippage given fluid political dynamics and that the return to a firmer growth trajectory will take longer than expected." (July 28)

Central Bank interest rate hits 14.25%

To curb inflationary risks from a steep depreciation of the currency, Brazil's central bank interest rate went up in July by 50 basis points to 14.25%—the highest rate since October 2006. The unanimous decision of its monetary policy committee was not unexpected. In its statement, the bank said keeping rates at that level for a sufficiently long period will be necessary if inflation is to converge to the target by late 2016. (July 30)

June primary deficit hits US$2.8 billion

The primary budget deficit (excluding interest payments) reached R$9.323 billion (US$2.78 billion) in June, mainly due to a steep drop in tax revenues as the economy weakens. The nominal deficit, which includes interest payments, was R$36.3 billion, bringing the 12-month result to 8.12% of GDP, up from 7.89% in May. (July 31)

Possible wage hike challenges austerity efforts

On August 5, in a 445–16 vote the lower house of Congress passed a bill to raise the wages of some public employees and police officers, at a cost of US$714 million a year. The bill, which alters the constitution, must still be subjected to another vote in the lower house and two rounds in the Senate. Passage would complicate President Rousseff's efforts to rebalance public accounts and retain Brazil's coveted investment-grade rating next year. (August 6)

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Finding the right balance for financing the economy

Brazil's current account deficit is narrowing—but how much longer will the world be willing to finance it?

Solange Monteiro

ONE OF THE FEW ITEMS OF good news for the Brazilian economy so far this year was that the external current account balance improved in the first half. It had been deteriorating since 2010, and at the end of 2014 had a deficit of 4.4% of GDP. For an economy that is barely moving, the 2014 current account deficit of US$104.9 billion was alarming, raising questions about Brazil's external vulnerability in 2015. Now a worse than expected downturn in economic activity is helping to narrow the deficit. In the first half of 2015, the current account had a deficit lower by 23.4% than in the same period of 2014, and the trade balance recorded a small surplus. "I am much more optimistic than I was earlier this year," says IBRE research associate Samuel Pessôa. "I think the external



imbalance is declining, and today assessment of Brazil's sovereign risk is more focused on the dynamics of public debt and fiscal policy."

IBRE is projecting that by the end of 2015 the current account deficit will fall to 3.7% of GDP, US$69 billion, down from 4.4% in 2014. For 2016, the estimate is for a further narrowing to 3.1%, US$61 billion. However, IBRE researchers Lia Valls and Livio Ribeiro point out that many factors may affect this outlook. "Trade balance risks continue with the prospect of low commodity prices and China's slower growth scenario, which makes Brazil more dependent on manufactured exports recovering," Valls says. "The exchange rate devaluation may help, but it does not transform into exports immediately, because we still have to address our structural problem of low productivity. … Nor should we forget that today the improvement of the external balance is associated with reduced economic activity and a fall in imports bigger than the fall in exports." According to the Ministry of Development, Industry and Foreign Trade (MDIC), Brazilian exports in the first half of 2015 totaled US$113 billion—15.5% less than in the same period of 2014, and imports at US$108 were 19.5% lower. Of the total drop in exports, 79% resulted from lower prices for oil, soybeans, and iron ore. Valls notes that, if Brazil's growth resumes and commodity prices remain low, the trade surplus is likely to decline.

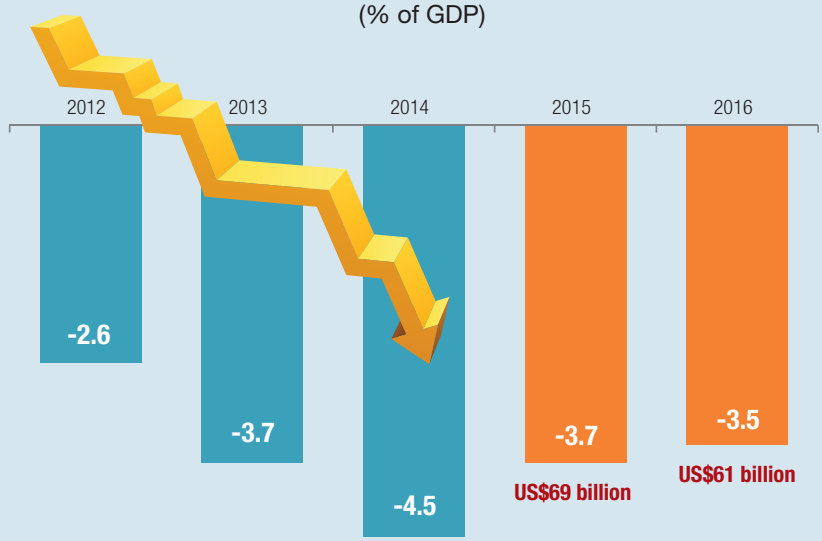
"The higher foreign savings, the higher are salaries, interest income, and dividends; people happily consume but it is a disaster for the country."

Luiz Carlos Bresser-Pereira

The services and income balances are also expected to improve. Ribeiro points out that less economic activity and exchange rate devaluation will result in less international

The external current account deficit raises questions about Brazil's external vulnerability

(% of GDP)



Sources: Central Bank of Brazil, IBRE projections.

Brazil: Balance of payments projections

US$ billion

	2014	2015
Current account	**-104.9**	**-69.1**
Trade balance	**-6.3**	**10.5**
Exports	224.6	194.0
Imports	230.9	183.5
Services and income	**-98.6**	**-79.6**
Interest payments (net)	-21.3	-22.8
Travel	-18.7	-13.2
Profits and dividends	-31.2	-18.1
Shipping	-9.1	-7.3
Other services and primary income	20.3	-19.9
Secondary income	2.0	1.7
Principal payments	**-49.6**	**-68.3**
Sources of financing	**165.4**	**152.2**
Net direct investment	70.9	54.5
Portfolio investment	40.8	45.0
Other investments	69.3	73.5
Other flows (incl. errors and omissions)	-15.6	-20.8
Reserve assets	**10.9**	**14.8**

Sources: IBRE estimates using the new Balance of payments manual, 6th edition (BPM6).

travel and lower profit remittances. He expects that the average exchange rate for 2015 will be R$3.21 to the US dollar, up 36% from R$2.35 in 2014. As for sources of financing, he sees a trend for direct investment in Brazil to drop: "Inflows of portfolio investments should be no problem, but foreign investors will ask for higher yields," he says, noting that the central bank is expected to hold its policy interest rate at 14.25% for an extended period, which will help to attract foreign investors.

Cyclical versus structural

Pessôa sees it as positive that the current external adjustment has a clear structural component. "At first, [the ongoing adjustment of the economy] seems all cyclical, since the decline in economic activity implies a lower current account deficit. But there has been an important structural change in the policy regime. When Brazil resumes growth, the external deficit will not grow to the same extent because fiscal and monetary policy has changed." Alexandre Barros, president of Datamétrica Consulting, agrees: "It was a policy mistake to prioritize inflation control by preventing the exchange rate from depreciating with foreign exchange swap operations, which resulted in a large external current account deficit. But the government realized it would not be able to continue to intervene in the exchange rate, and now we have a structural correction."

Afonso Celso Pastore, former president of the Central Bank, says that the exchange rate has depreciated because the external current

account was too large, but such factors as the appreciation of the U.S dollar, the fall in commodity prices, a major slowdown in world exports, and an increase in the perception of Brazil risk have also contributed. "Devaluation was the only solution," he says. Braulio Borges, chief economist at LCA Consultancy, points out that the current exchange rate is about 40% higher than it was five years ago and it is likely to hold at that level for several years. However, he estimates that it would take two years for the exchange rate devaluation to have its full positive impact on the external current account.

Pessôa and Borges recognize that Brazil's structurally low savings rate requires foreign savings to finance growth and the external current account deficit. The external current account is the difference between national savings and investment, and a current account deficit may therefore reflect a low level of national savings relative to investment. "We have to accept that our economy is more like that of Australia or Chile, countries whose current account deficits are consistently in the range of 2.5% to 3% of GDP," Borges says.

"Growth feeds the world's willingness to finance us."

Livio Ribeiro

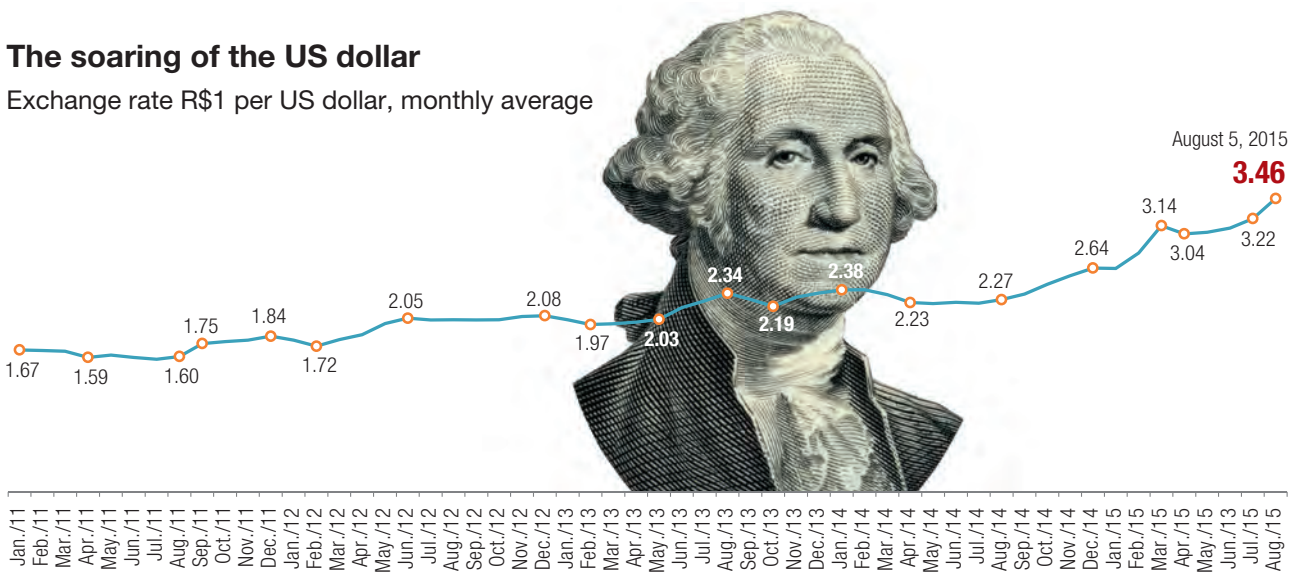
But what would be an acceptable external current account deficit for Brazil? The appropriate limit, Borges thinks, would be below the long-term average of foreign direct investment in Brazil: "Since foreign direct investment has been running close to 3% of GDP, in our case the ideal would be to maintain a safe level of 2% to 2.5% of GDP."

Exchange rate and external surplus

Borges estimates that an exchange rate of R$3.20 to the US dollar would be sufficient

The soaring of the US dollar

Exchange rate R$1 per US dollar, monthly average



Source: Central Bank of Brazil.

"The idea that we need to attract foreign savings to finance our development is gibberish. In fact, what ends up happening is that by attracting foreign savings, the exchange rate appreciates, and in that way it reduces domestic savings. We have to do the opposite."

José Luis Oreiro

to keep the external current account deficit within a safety margin of 2–2.5% of GDP. He sees several indications that the competitiveness of the Brazilian real is improving. One example is the popular Big Mac Index: in the mid-July edition of *The Economist*, for the first time since 2007 the index showed that a Big Mac hamburger in Brazil was 10.6% cheaper in U.S. dollars than in the United States. Another indicator is Brazilian industry unit labor costs measured in dollars, a statistic compiled monthly by the Central Bank; in June it reached the lowest level since 2009. "In the last two years, there has been an important correction [in the unit labor cost] because either the Brazilian currency has depreciated against the dollar or wages in local currency have declined due to the recession," Borges says. "This indicates that the competitiveness of industry has improved. The exchange rate is already showing signs of having reached equilibrium."

Would further exchange rate devaluation be advisable in order to zero the current account deficit? José Luis Oreiro of the Federal University of Rio de Janeiro challenges the argument that the structure of the Brazilian economy makes it impossible to have external current account surpluses. "We had a positive current account balance from 2003 to 2007," he points out, "and before 1994 we also had surpluses." Oreiro believes that only with current account surpluses will the exchange rate reach the level necessary—close to R$4 per US dollar, he estimates—to induce more robust long-term growth. He argues that domestic savings are reduced when Brazilian policy emphasizes attracting external financial sources. In Oreiro's opinion, "The idea that we need to attract foreign savings to finance our development is gibberish. In fact, what ends up happening is that by attracting foreign savings, the exchange rate appreciates, and in that way it reduces domestic savings. We have to do the opposite."

Luiz Carlos Bresser-Pereira, former finance minister and FGV emeritus professor, considers the external current account to be a synonym for immediate consumption. He says, "I agree with Pessôa that we save little. In Brazil we have a high propensity for consumption. But while Pessôa says that there's no way to change this, I say maybe there is." He believes the key is to recognize that the deficit reflects imbalance,

not investment. "The higher foreign savings, the higher are salaries, interest income, and dividends; people happily consume but it is a disaster for the country." Alexandre Barros of the Federal University of Pernambuco state (UFPE) reinforces this point: "Brazil's savings are not fixed … companies also save, and save more when they have to pay for investments made previously. With more investment, savings will increase."

For Oreiro, Barros, and Bresser-Pereira, the formula for increasing savings and building the external surplus is more intervention to devalue the exchange rate and more tax increases. Oreiro argues that structural adjustment of the external current account implies a permanent change in the real exchange rate to bring it closer to R$4 per US dollar than R$3. To devalue the exchange rate, he advocates tighter fiscal policy and more expansionary monetary policy, arguing that "A stronger fiscal adjustment would allow a reduction in interest rates and a more sustainable debt-to-GDP ratio." He notes that "The first Cardoso administration [1995–98] operated with a fiscal primary deficit; early in the second Cardoso administration the primary surplus rose to 3.75% of GDP, primarily through tax increases. Today this cannot happen because the Rousseff administration lacks a cohesive base of support in Congress to make this kind of adjustment." Barros believes that Brazil should tax foreign currency flows, which would make it possible to raise the domestic interest rate to control inflation without forcing an appreciation of the exchange rate.

For an economy that is barely moving, the 2014 current account deficit of US$104.9 billion was alarming, raising questions about Brazil's external vulnerability in 2015.

For his part Bresser-Pereira supports taxation of commodity exports. That could make up for the difference between an exchange rate for the current account equilibrium that is close to R$3.20 per US dollar, and a rate for industrial competitiveness of about R$3.65, which would make exports of sophisticated goods and services profitable. With such a tax, the cost to produce and export commodities rises and the exchange rate depreciates until the two exchange rates coincide, ensuring the competitiveness of industry.

Pessôa acknowledges that the main difference between these policy recommendations has to do with how Brazilian capacity to save is evaluated. "Many economists agree that to have a devalued and competitive exchange rate requires higher public savings, and a high primary fiscal surplus of 5% of GDP. I think if we reach a surplus of that size, interest rates will fall and the exchange rate will depreciate naturally," he says. "The question, however, is

A worse than expected downturn in economic activity is helping to narrow the deficit.

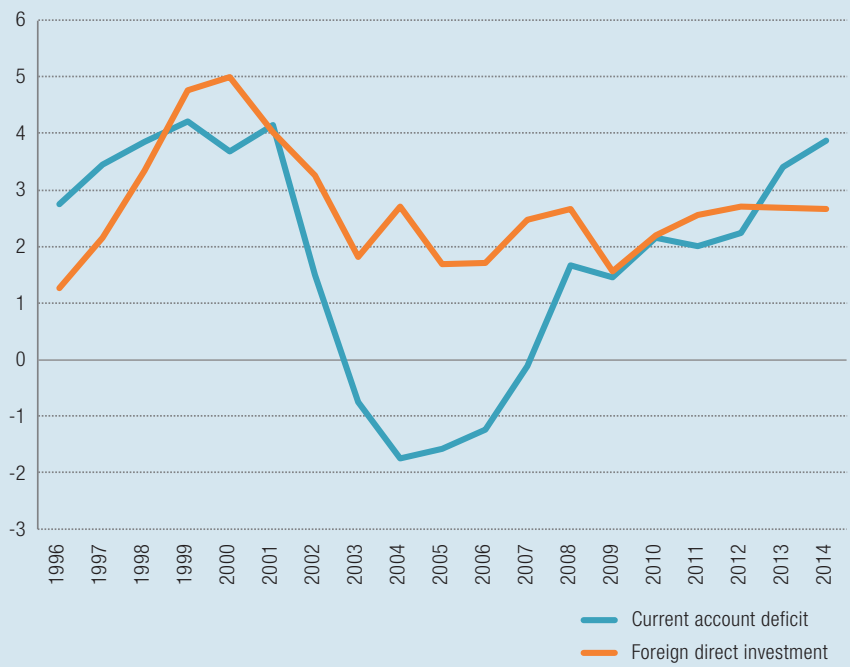
how to achieve a large enough primary fiscal surplus, and how much intervention will be necessary to ensure a competitive exchange rate." Pessôa is against raising taxes because the tax burden is already high. In his opinion a middle-income country like Brazil cannot have a tax burden of 40% of GDP.

Borges believes that at this point, "Monetary policy should seek to preserve the recent real exchange rate depreciation." He argues that if the Central Bank targets inflation of about 4.5%, Brazil's inflation would not be far from average global inflation, which according to the International Monetary Fund is about 4% a year. "The closer we stick to it, the less inflation will erode the depreciation of the exchange rate attained so far," he says. Borges also advocates that the Central Bank reduce its foreign currency swaps to signal that it will let the exchange rate float.

IBRE's Ribeiro points out that the external balance also depends on Brazil's success in adjusting the fiscal balance and on growth resuming. "Growth feeds the world's willingness to finance us," he says. He cites the case of Australia: even though it has had a high external current account deficit for decades, it has never suffered a severe balance of payments crisis because it has continuously managed to attract external financing. Another critical factor, in Ribeiro's opinion, is whether Brazil will retain its investment grade rating, which may affect foreign direct investment less then portfolio investment. "That's another door of external financing that can close if we cannot maintain our investment grade rating," he says.

Brazil: External current account versus foreign direct investment

% of GDP



Sources: Central Bank of Brazil and IBGE.

India and Brazil: Trading partners?

Solange Monteiro

INDIA'S HIGH GROWTH OUTLOOK and the possibility it might surpass China's, is feeding speculation about how much India will add to world demand, especially for Brazil's commodities exports.

Braulio Borges, LCA Consultancy, believes there is hope that India's demand for commodities will go up, but that probably will not be soon: "It will be difficult for something to happen in the next five years. India's imports of commodities are mostly fuel, precious stones and metals, and nonagricultural goods. Its imports are very different from China's." He adds that "Unless India invests massively in infrastructure, it is unlikely that its demand for metal commodities will rise. India's demand will not be more significant for another decade."

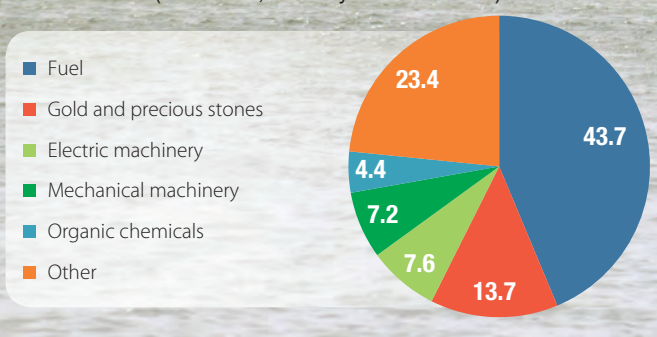
José Augusto de Castro, president of the Foreign Trade Association of Brazil (AEB), points out that India is gradually opening up to foreign trade. In 2005–09, for example, it

In 2014, Brazilian exports to India totaled **US$4.78** billion, just over **1%** of the country's imports

Photo: Mumbai Port.



India's imports
(% of total, January-October 2014)



Source: Brazil's Ministry of Foreign Relations.

Brazil's export opportunities to India

Hides, leather and artifacts	2.85	542
Personal care and cosmetics	1.29	729
Pesticides	2.08	772
Soybean oil	13.38	1,033
Pharmaceutical products	2.16	1,631
Flat rolled iron and steel	0.71	4,858
Copper ore	6.82	6,936
Oil and oil derivatives	0.97	182,405

Brazilian share of India's imports in 2013 (%) | India's total imports in 2013 (US$ millions)

Source: National Export Plan, Ministry of Development, Industry and Commerce of Brazil.

In 2014 India was 19th among the most dynamic countries in international trade; Brazil was 25th.

has cut import tariffs by an average of 20.24%, to 13.89%, and between 2009 and 2013, its trade increased by 81%. "In 1990, while Brazil accounted for 0.9% of world trade, India had only 0.65%. Since 2008, however, India has surpassed Brazil, accounting for 2.21% of world trade compared to 1.23% for Brazil," he says. As a result, in 2014 India was 19th among the most dynamic countries in international trade; Brazil was 25th.

Castro believes that India's high growth prospects could be beneficial for opening up sectors where there is more protectionism, such as agriculture, which employs more than half of the Indian workforce and accounts for about 19% of its GDP. India has one of the youngest populations in the world and only 30% of its people live in urban areas. If India can reconcile rapid growth with the challenges of urbanization and poverty reduction, it can become a major consumption market. "India is the only country other than China with a population of over 1 billion people. With economic expansion and increased demand, India will not be able to ban foreign competition; it will be forced to open its markets," he says.

As yet Brazilian trade with India has been small and not very diversified. In 2014, India's purchases accounted for 2.13% of Brazilian exports. Of the US$4.78 billion in exports, half was crude oil, trailed by sugar and soy oil. "Our trade balance with India was unstable, without a logical sequence," says Castro. In 2014, Brazil's trade balance with India recorded a deficit of US$318 million, driven by the fall in the price of crude oil.

In the National Plan for Exports that the Brazilian Ministry of Development, Industry and Foreign Trade released in June, India is identified as a priority trading partner, along with the United States, the European Union, and the other BRICS. Segments where the ministry believes Brazil would have opportunities to start or expand sales to India range from fruits to machinery and equipment for earthmoving and drilling—which is a half-billion-dollar market of which Brazil supplied less than 1% of the total purchased by India in 2013. In its plan, the ministry states that the trade agenda with India should be coordinated with Brazil's partners in Mercosur, which is expected later this year to expand the tariff preference agreement it has had with India since 2009. "Brazil needs to have more ambitious expectations," says Castro. "The agreement we have with India is still very limited, and today we are dealing with a country that looks at the international market differently. We need to advance."


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The problem of managing natural resource revenues

Experts discuss the resumption of Brazilian growth from the perspective of the commodities sector.

Solange Monteiro

AS THE CHINESE ECONOMY SLOWS and oil prices fall, countries that export commodities are rethinking the role of these products in their economies. Falling commodities prices have already had a painfully negative effect on Brazil's external accounts: the 2011 trade surplus of US$29.8 billion turned into a US$3.9 billion deficit in 2014. This has fueled debate on how much the previous commodities boom was responsible for Brazil's current economic crisis.

In general, the hypothesis of a natural resource curse in which abundant natural resources invariably lead to excessive specialization and in the long run to stagnation has not proved conclusive, any more than has "Dutch disease." The latter term was coined by *The Economist* in the 1970s to describe



what happened to the country's economy when the Netherlands discovered natural gas in the late 1950s; gas exports appeared to force a currency appreciation, a decline of manufacturing, increased unemployment, and lower growth. "This is a polarized debate, but there is already some consensus that expansion of commodities may limit growth," said IBRE researcher Regis Bonelli. He believes that the Netherlands itself has set a good example, however, by correcting its economic imbalances since the 1970s; today its productivity is near U.S. levels and manufacturing accounts for about 60% of total exports.

To discuss the relationship between natural resources and growth, in July the Getulio Vargas Foundation (FGV) held a meeting in Rio de Janeiro of researchers from Brazilian universities and research institutes.[1] The meeting followed up on discussions initiated in São Paulo in 2010. At the time, experts pointed out that among the differences between countries that were able to manage the advantages of natural resources, such as Australia and Norway, and countries that were not, such as Nigeria and Venezuela, were good governance, higher-quality institutions, and careful management of the income generated when commodities prices were high.

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Roberto Castello Branco, professor, FGV Graduate School of Economics, and member of the board of state-owned oil company Petrobras, cited Chile as a successful example of management of natural resources income. In Chile, he said, "The focus was on a countercyclical fiscal policy with the creation of a sovereign wealth fund, which enables stable macro management." Castello Branco pointed out that Chile has two separate economic councils. One estimates the effective potential output of the entire economy; government policy is designed to produce a fiscal surplus when economic activity is above potential or to be expansionary when activity is below potential. The second council is dedicated to copper, comparing market prices in the short term with the long-term estimates: copper revenue, which comprises 13% of the Chilean budget, must be spent on the basis of

[1]University of Campinas (Unicamp), University of São Paulo (USP), The Institute of Applied Economic Research (IPEA), Pontifical Catholic University of Rio de Janeiro (PUC-RIO), and Brazilian Institute of Economics of FGV.

"Between 2003 and 2008, Chile accumulated a fiscal surplus of 9% of GDP, which generated social pressures for more spending. But the government chose to use some of that surplus to pay down debt and set up a sovereign wealth fund."

Roberto Castello Branco

a long-term, independently verified planning price; revenues above that are accumulated in a fund to be drawn upon when copper prices dip. "Between 2003 and 2008, Chile accumulated a fiscal surplus of 9% of GDP, which generated social pressures for more spending. But the government chose to use some of that surplus to pay down debt and set up a sovereign wealth fund, which was then available to draw on during the collapse of commodities prices in 2008-09 as well as paying for the damage caused by 2010 earthquake," Castello Branco explained.

Edmar Bacha, director of think tank Casa das Garças, pointed out that in Brazil, the commodities supercycle was not accompanied by careful monitoring of domestic spending: "In 2003 we had an evident lack of spending relative to GDP. That has changed. In 2013 we spent 7% more than we brought in, because of both better export prices and external financing." He noted that "Between 2005 and 2013, Brazil earned 10 percentage points of GDP with the external bonanza; we spent 5 points on consumption and invested 5. Because consumption is more difficult to reduce than investment, today fiscal adjustment is necessary." He also demonstrated that Brazil is increasingly vulnerable to the "natural resource curse." Bacha's estimates confirm the close relationship of exchange rate appreciation and the decline in the share of industry in GDP between 1988 and 2011; he also noted the influence of the terms of trade on total productivity, which he estimates to have declined from annual average growth of 2% in 2004–10 to 0.2% negative growth in 2011–14—a worrying factor for growth sustainability.

Educate and diversify

IPEA researcher José Feres pointed out that the risk caused by concentration on export commodities can be mitigated with good institutions and pro-diversification policies. Research has found that, when factors such as stock of knowledge and trade liberalization are accounted for, there is no correlation in Latin American countries between commodities exports and growth. In his opinion, the problems of Latin American exporters of commodities are related much more to a lack of economic integration of their economies and the ability to use such leverage to promote the emergence of innovative sectors. "This

has to do with the region's low investment in education and research, and its isolationism," he said. Ultimately, such deficiencies prevent diversification of the economy and better utilization of the commodities sector, which during periods when prices are low needs to enhance its competitiveness.

Claudio Frischtak, president of InterB consultancy, saw agricultural commodities recovering somewhat in coming years, still sustained by Chinese demand. "The fact is," he said, "that in the short term there is no economy that can replace the Chinese engine in all sectors. Even though India this year is expected to surpass China in GDP growth, it would take at least a decade for it to eventually drive a new commodities supercycle."

Unicamp's Mariano Laplane pointed out that reversing specialization of the economy has become increasingly complex with the emergence of increasingly autonomous structures for intermediate goods and services that compete in global supply chains. Frischtak commented that diversification of the productive system of countries with abundant natural resources requires development of innovative clusters around natural resource activities, noting, "For this, we will have to address significant educational deficits in Brazil, especially those related to science and engineering education; reform immigration laws to attract skilled professionals; and improve the business environment, especially for small and medium enterprises that can develop these clusters."

"Between 2005 and 2013, Brazil earned 10 percentage points of GDP with the external bonanza; we spent 5 points on consumption and invested 5. Because consumption is more difficult to reduce than investment, today fiscal adjustment is necessary."

Edmar Bacha

The experts reiterated that comparative advantage in natural resources can also be created. "Just remember that the success of the coffee exports for decades derived not only from adequate soil, but from the railway and the Imperial Agronomic Station of Campinas, created in 1887," recalled João Furtado, USP, underscoring the importance of investment in research and development (R&D) if Brazilian agriculture is to become more competitive. PUC-Rio's Elói Fernández y Fernández who is CEO of the National Petroleum Industry Organization (Onip), emphasized the importance of efficient allocation of R&D resources: "Since the relaxation of the monopoly 15 years ago, the oil and gas sector has invested about R$15–20 billion in technological development. However, almost the entire amount was

"In the short term there is no economy that can replace the Chinese engine in all sectors. Even though India this year is expected to surpass China in GDP growth, it would take at least a decade for it to eventually drive a new commodities supercycle."

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directed to research universities; very little went to companies, which was not positive." He highlighted the growing importance of technology and innovation for the oil and gas sector, especially to reduce operating costs. "When deep sea oil exploration began, drilling a well cost about US$300 million. Today it costs a third of that. That's technology," he said.

The mining sector, particularly oil and gas, is confronted by significant institutional obstacles. A February survey of nearly 500 CEOs by the Canadian Fraser Institute ranked Brazil 87th among 122 countries in terms of national policies for the mining sector. "Why are we behind?" Castello Branco asked. "Because of the institutional environment and the difficulties in obtaining environmental licensing; as a result Brazil was not able to fully exploit the commodities supercycle." He also acknowledged that the oil and gas situation is particularly fragile: "We had too much government intervention in an attempt to transfer resources from the oil and gas sector to domestic industry by requiring oil and gas operators to buy from local shipbuilding, construction and equipment suppliers. This plus the controls on domestic fuel prices, which favored the auto industry, caused huge losses to Petrobras." He pointed out that for Petrobras to meet its more modest investment target—in June, the plan for 2015–19 was reduced from the previous 2014–18 goal of US$220.6 billion to US$ 130.3 billion—the company will have to rely on discipline and rigor.

Castello Branco also said that the sharing contracts for oil exploration do not help: "The auction system with oil in payment does not maximize government revenues. Today, if we were exploring the deep-sea oil under concession contracts, the government would be collecting oil revenues, which would be extremely important for balancing its budget."

How long will fiscal discipline last?



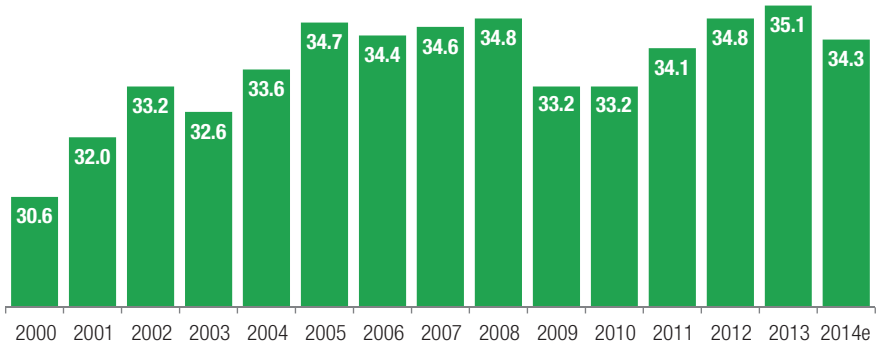
Recession and falling government revenues are putting the Fiscal Responsibility Law to the test.

Solange Monteiro

THE ECONOMIC DOWNTURN not only makes it more difficult for Brazil to meet the fiscal primary surplus target—reduced in July from the previous guesstimate for 2015 of 1.2% of GDP to a mere 0.15%—it is also testing whether the Fiscal Responsibility Law (FRL) can continue to be effective. Created in May 2000 to set limits in order to promote long-run fiscal stability, the law has supported fiscal management and been fairly successful for 15 years. The main goal in creating the FRL was to reduce the indebtedness of states, and indeed the number of states that had more debt than the FRL limit of 200% of net current revenue has since dropped from seven in 2000 to just one in 2013.

This positive result, however, points out José Roberto Afonso, IBRE researcher and member of the government team that drafted the FRL bill, was driven by a dramatic rise in taxes. Afonso and his colleague economist Kleber Castro estimate that the tax burden went up from 30.6% of GDP in 2000 to 35.1% in 2013. But as all Brazilians are aware, in recent years the situation has changed. "The reality of the last 15 months is not the same as it was in the previous 15 years," Afonso says. "Last year the government collected taxes amounting to 34.3% of GDP, the same as in 2007; if the trend of falling tax revenue in the first half of this year continues, tax revenues would decline another 1 percentage point of GDP, back to where we were in 2005." Today the government has little room to increase taxes, as is clear from the difficulty it is having in rolling

Brazil's tax burden post-Fiscal Responsibility Law, 2000-2014
(% of GDP)



Source: IBRE.

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José Roberto Afonso

back tax exemptions. "Corporate income tax revenue is falling because of the slowdown in economic activity, and expectations of a new federal tax amnesty," Vilma da Conceição Pinto, IBRE researcher, explains. From January to June 2015, the total revenue of the federal government was 4.6% lower than in the same period of 2014 but revenues from corporate income tax plunged 16.1%.

Afonso believes that the current economic slowdown, rising unemployment, and falling consumption and revenue, are making clear the cost of postponing FRL reforms, noting that "So far it has been assumed that managing fiscal policy was enough, and the rules were ancillary. We did not even push for reforms in the first term of President Lula, when the government had a large majority in Congress and popular support."

Among the shortcomings of the FRL is that there is no ceiling for federal government debt. The limit for states is 200% of current net revenue and for municipalities it is 120%, but there is no such limit for the federal government. Afonso also notes that the recording and accountability of federal fiscal accounts is seriously deficient. "If we were to record the fiscal balance on an accrual basis, we would certainly have more consistency and accountability, and there would be no accounting gimmicks involving the use of the funds of state-owned banks to make up the federal budget—something now being investigated by the Court of Audit [TCU]," he says. The TCU is also concerned about the lack of consistency in the accounts of the federal government, the states, and municipalities. The federal government records its accounts on a cash basis; state and municipality accounts are more transparent because they are kept on an accrual basis, as the FRL requires.

Temporary truce

With the loss of dynamism of the economy, states and municipalities are finding it difficult to meet the limits on personnel spending. So far this year, 26 states and the Federal District have gone over the personnel cap of 49.1% of net current revenue—among them Mato Grosso, Tocantins, Rio Grande do Norte, and Alagoas states—and another 18 states hit the prudential limits of 46.55% and the alert limits of 44.1%.

However, when the economy slows, states and municipalities that violate spending limits are not penalized by cut-backs in federal resource transfers and loans. The FRL allows states and municipalities twice as much time to bring their spending back under the limits when GDP growth is less than 1%: In normal situations, they have two quarters to get spending back under control, but when GDP growth is low, it can take up to four quarters. Also, as long as GDP does not recover, the spending limits will continue to be pushed forward, giving more time to states to meet their spending limits. So "If we take into account the current growth projections, states and municipalities would have until at least 2018 to meet the spending limits," calculates Afonso.

In four years, the Treasury more than tripled its guarantees of state and municipal borrowing, from 0.5% of GDP in 2010 to 2% in 2013. The situation is aggravated by the fact that a significant portion of these loans were from Brazilian state-owned banks. Afonso points out that "In 1998-99, Treasury guarantees were for states and municipalities negotiating loans with international financial institutions like the World Bank and the Inter-American Development Bank. No one thought the Treasury would guarantee loans from national state banks. This is serious." He says that the grace period of these state bank loans is ending and servicing debt may take 15% to 20% of state revenues.

States feeling the resource pinch are withdrawing escrow deposits related to pending court trial against them such as taxes. Earlier this year, Senator José Serra (PSDB party-São Paulo state) proposed a bill to regulate this practice, allowing states to withdraw 70% of these deposits but creating a reserve fund with the remaining deposits. Serra pointed out that in 2015 the arrangement could bring in R$21.5 billion to state and municipal budgets. In late July, President Dilma Rousseff signaled her intention to sanction the use of escrow deposits for court-ordered payments of the debts of states and municipalities. Afonso comments that "It is not clear how much has already been drawn down, but there is concern that the practice may already be problematic in macroeconomic terms, and deserves attention."



Reduction in state debt levels was accompanied by increases in personnel expenses, generating fiscal imbalances.

Considering the number of potential time bombs, to preserve the FRL, Afonso argues that priority should be given to reforms that would improve monitoring of fiscal performance. His recommendations: (1) Set debt limits for the federal government, as had been envisaged in the FRL, but has never been actualized (2) Review yearly the limits prescribed by the FRL—which have never been honored. (3) Create the fiscal management council that is also mandated by the FRL, though it was never established. The council would have a regulatory role, setting budget and accounting classifications and the consolidation of public accounts. This change would make the public accounts more credible.

Afonso also suggested other reforms to correct flaws in established practices and specify regulations currently lacking in the FRL. Among them might be regular review of Treasury guarantees for state and municipal loans and assessing the debt sustainability of states and municipalities whose revenue outlook is questionable. Conceição Pinto is also troubled by the rigidity of required spending: "When revenues are falling, we see many problems arising because revenues are earmarked for specific purposes when other sectors need that money more." At the end of the day, giving more attention to reform would bring about more fiscal transparency and strengthen the credibility of the FRL.



In the first half, the federal government accumulated a fiscal primary deficit of **US$1.6** billion

Afonso believes that today Congress has more desire to make reforms: FRL reform projects are being considered in both houses of Congress, and there are initiatives in the most indebted states to adopt state fiscal responsibility laws. His conclusion is that "This signals a disposition for structural reforms—and we must seize it."

LNG in Brazil and beyond

Ieda Gomes
Energy consultant to FGV

INTERNATIONAL TRADE in liquefied natural gas (LNG) grew 1.8% in 2014, reaching 241 metric tons per annum (mtpa)—about 33% of world trade in gas. In 2014 exports by pipeline totaled 1.82 billion cubic meters a day and traversed 39 countries.

Currently, 19 countries produce LNG and 29 import it. The increase in the number of producers in all geographic areas ensures greater security of supply. Qatar is the largest producer of LNG (76.8 mtpa), followed by Malaysia (25.1 mtpa) and Australia (23.3 mtpa). In 2018, Australia will become the world's largest producer, with over 80 mtpa. In the United States 50 projects for exporting LNG have been approved, though only 4 are under construction.

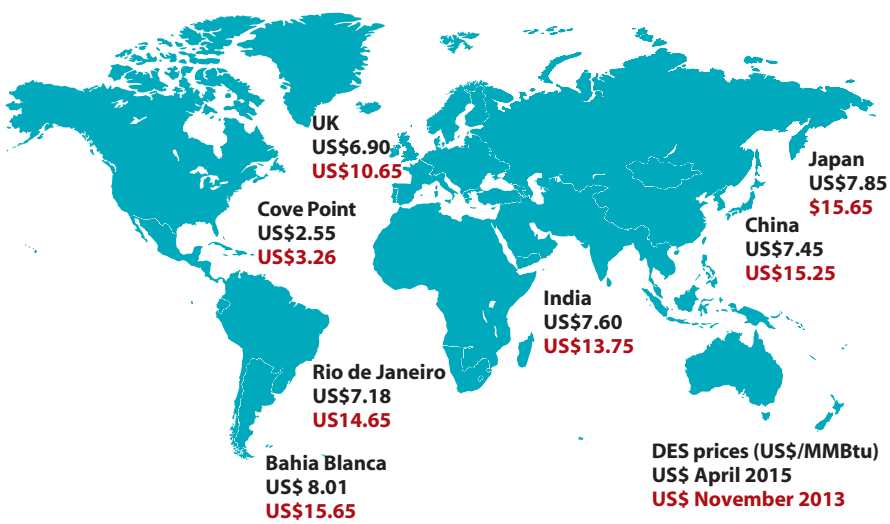
The Asia Pacific region is the largest import market, accounting for 75% of the total. In 2014 Japan consumed 88.9 mtpa. Consumption in the Americas reached 23.6 mtpa, with Brazil, Argentina, the Dominican Republic, Puerto Rico, and Chile consuming 15.2 mtpa—about 6% of world consumption.

By the end of 2014, when oil prices were above US$100 a barrel, new LNG projects planned in the US, Canada, Mozambique, Russia, and Australia totaled almost 900 mtpa. Given the limited number of companies qualified to build LNG plants and the cost inflation of materials and labor, investment in gas liquefaction reached US$1,400 per ton, equivalent to US$5-6 per MMBtu (million British thermal units). To these add production and transportation costs to the liquefaction plant, plus transportation costs by ship to the destination. LNG suppliers are seeking to obtain long-term prices ("delivered ex-ship," DES) of 14% to 15% of the Brent oil price to make their projects viable.

With a Brent oil price of US$100 per barrel, the price of LNG DES would be US$14-15 per MMBtu. Adding US$0.5-1.5 /per MMBtu for regasification, the LNG at the city gate would reach US$14.5-16.5 per MMBtu, which is not competitive in emerging markets, where the price of domestic natural gas and alternative fuels is often subsidized, as in Argentina and the Middle East. In such cases, the Treasury or the national oil company picks up the losses.

The price of LNG on the spot market tracked the decline in oil prices: Between 2013 and 2015 spot prices fell by 50%. North American, European, and Asian markets have different reference prices. In the United States prices are referred to the Henry Hub spot price (HH), which fell substantially as shale gas supply went up. In northern Europe, LNG prices are referenced to prices

DES LNG spot prices in regional markets
(US$/MMBtu)



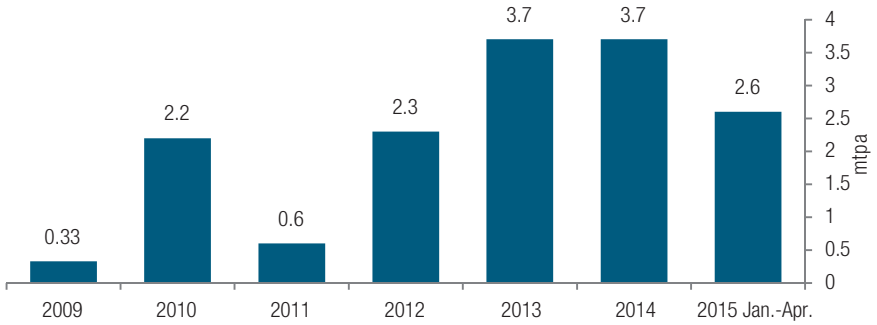
Souce: Federal Energy Regulatory Commission, Market Oversight, 2013 and 2015.

of contracts of gas imported through pipelines from Norway and Russia, which are tied to a price basket of oil and fuel. Spot prices in Asia are pegged to oil prices. When demand for LNG is high, suppliers arbitrate prices according to Asian demand, moving LNG volumes from the Atlantic Basin to Asia when transportation costs by ship are lower than the price differences between the two regions.

LNG spot prices for delivery in April 2015 converged in all markets, including Brazil; they fell between November 2013 and April 2015, reflecting much higher supply than demand and low oil prices.

Currently, in Brazil only state-owned oil company Petrobras imports LNG, which it uses mainly to supply thermal power plants. Brazil's LNG imports have increased significantly because prolonged drought has reduced hydropower generation, which has been replaced by thermal.

Brazil's imports of LNG



Source: Ministry of Mining and Energy, Monthly Buletin of Natural Gas Industry, May 2015.

Comparing DES LNG prices

Brent *vs.* Henry Hub

Henry Hub (US$/MMBtu)	Brazil DES price (US$/MMBtu)	Brent (US$/barrel)	DES price (15% of Brent) (US$/MMBtu)
3	7.9	30	4.5
4	9.0	40	6.0
5	10.2	50	7.5
6	11.3	60	9.0
7	12.5	70	10.5
8	13.6	80	12.0
10	15.9	100	15.0

Source: Author's estimates based on published projects.

According to the Ministry of Mines and Energy, since 2009 Petrobras has spent more than US$10 billion on LNG imports and at least US$1 billion in additional transportation costs. It has imported LNG from Qatar, the United Arab Emirates, Nigeria, Norway, Trinidad and Tobago, Spain, and the United States.

The supply of LNG is equivalent to 20% of the gas supply to the Brazilian market. Petrobras import capacity is 41 million cubic meters per day (mmcmd) in port terminals in Ceará, Rio de Janeiro, and Bahia states. There seems to be spare capacity because the maximum volume of regasification was 24.5 mmcmd in May 2014.

Brazil's demand for LNG is expected to increase. The 2014 energy auction offered two thermal power plants of 1,230 MW each fueled by imported LNG, and the 2015 auction offered another thermal power plant of similar capacity. Brazilian energy planning should encourage a greater share of LNG in Brazil's gas market because Petrobras has drastically reduced investments in exploration and gas, which in the long run will reduce the domestic supply. Bolivia, which accounts for 30% of Brazil's gas market, needs US$12 billion to maintain gas supply to its domestic market and to Brazil and Argentina.

Using a cost-plus pricing formula based on HH gas spot prices and assuming a cost of liquefaction US$3 per MMBtu, LNG DES cost of 15% of the Brent oil price and US$1.40 per MMBtu for transport to Brazil, U.S. LNG would be competitive when the Brent oil price is above US$60 a barrel and the HH gas spot price is below US$7 per MMBtu. If oil prices again go up to US$100 per barrel, LNG prices are expected to increase to US$14-15 per MMBtu.

Photo: Vivo.



Lower taxes can promote digital inclusion

Amos Genish

President of Vivo

Solange Monteiro

Amos Genish has a major challenge in 2015: He has to replicate in Vivo the same agility and performance formula that marked GVT, the phone company he helped to create in 2000 that was sold to the French group Vivendi for R$7.7 billion (though he continued to lead the company). Last June, GVT was sold to the Spanish group Telefónica for R$22 billion, a process completed in March this year. After conducting business in Brazil for 15 years, Genish, who is Israeli, is optimistic about the recovery of the Brazilian economy but said that fiscal adjustment should concentrate on cutting public spending because "Additional taxes may severely affect the ability of companies to make investments and harm the consumers of services." He points out that Brazil has the highest taxation of the 10 countries with the largest number of mobile phone customers. "Reducing the tax burden would bring many benefits to people by integrating them into the digital environment and consequently promoting their social inclusion," he says.

***The Brazilian Economy*—What has been the most important challenge in taking over Vivo? Is it possible to make it as agile and efficient as GVT?**

Amos Genish—When the Telefónica Group announced that I would lead Telefónica Vivo, it also announced a change in the company structure: one person would be both general manager and chairman, which considerably speeds up company decision-making. My challenge is to unite the very best of Vivo and GVT. We want to solidify our company's

leadership as an integrated digital telecommunications company in Brazil, reaching the highest growth and profitability in the sector. Less than a week after the Brazilian Council for Economic Defense (CADE) approved the merger of Vivo and GVT, we started planning how to integrate the companies. The planning was comprehensive, with many people participating. In late May, we had a detailed plan for integration, which was launched in June at an event for more than 150 executives. Our goal is that before yearend our customers will begin to see the fruits of this integration.

How has the Brazilian economic crisis affected the telecom sector?

Although the economy is experiencing a period of challenges and adjustments, we have confidence in the potential of the Brazilian market and that the economy will return to higher growth. I am an optimist. I have been in Brazil for 15 years and have had many opportunities. Of course there are better and worse years, but on average, Brazil is a country of opportunities. Telefónica Vivo is a long-term investor in Brazil and believes that the downturn is temporary. Despite its current difficulties, globally Brazil is one of the countries that offer the best business opportunities in all segments. The country accounts for 30% of Telefónica's customers in the world. … I think the fiscal adjustment being carried out is a good start and could pave the way for growth to resume. But these adjustments should be more focused on cutting expenses than increasing the tax burden on society.

Should the Brazilian telecom market undergo consolidation in coming years?

Telefónica Vivo is a long-term investor in Brazil and believes that the downturn is temporary. Despite its current difficulties, globally Brazil is one of the countries that offer the best business opportunities in all segments.

The telecommunications market has already been going through major consolidation in recent years. It is likely that this process still has a few more steps to go, but nothing will change the market dynamics significantly.

How do you see Vivo's position in the market? What are the company's estimates for investment and growth?

The merger of GVT and Telefónica Vivo has already produced the largest and most profitable telecom and cable TV operator in Brazil. We have more than 106 million lines and the highest profitability in the market, with an EBITDA margin of about 30%.[1] We are leaders in the mobile phone and ultra-speed broadband (over 12 mbps) markets.

We have to move forward to further integrate Vivo and GVT, making it a single company with a unique culture and identity. This should help us to capture the benefits of combining the assets

[1]EBITDA, a measure of a company's operating profitability, equals earnings before interest, tax, depreciation and amortization, divided by total revenue.

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and business models of both companies. For example, we have discovered that there is much complementarity between the telecommunications networks of the two companies. In some regions, the GVT network will be connected to the Vivo network, expanding its capacity and coverage; in others, it will be the opposite. There are numerous similar opportunities, and we must move quickly to make them a reality.

Vivo investment in 2015 will be about the same as in 2014, R$8.4 billion for Telefónica Vivo and GVT combined, excluding spending on licenses. The company invested R$2.1 billion in the second quarter of 2015 to expand the coverage infrastructure and improve service quality. We have invested in expanding the coverage of fourth generation technology and increasing 3G capacity. Currently, our 4G services cover 140 cities, home to 80.5 million people. So far this year, investment already totals R$3.8 billion, 7.5% higher than in the first half of last year.

Our main concern is constant improvement of quality in both fixed and mobile phone services and pay TV. Demand for mobile data services is still strong. We are working to integrate and expand our subscriptions for triple-play packages [broadband, pay TV, and fixed telephony] nationally, and we plan to soon offer quadruple packages, combining mobile service with triple play. We will also expand our operations in the corporate market throughout Brazil.

What is the expected impact of competition from Internet companies like Google, and Facebook offering data and voice services?

Because we are attentive to the new dynamics of the telecom market—with consumption of data increasing and competition from Internet companies—we chose to reinvent our business to turn Telefónica into a digital telco. Connectivity remains at the heart of our business, but we also want to offer relevant digital solutions that will make life easier for our customers, whether at leisure or at work. This is a global strategy for the Telefónica group and Vivo is one of the operators within the group that has advanced most in this regard. As a digital telco, we can compete on equal terms with services from outside the telecom sector. And we have the advantage over them of direct access to and knowledge of our customers. This is undoubtedly a huge advantage. The Internet companies offer globally services similar to those offered by traditional telecom operators locally. Telefónica wants to compete, but on equal terms, with the same rules for all operators in the Internet ecosystem.

Which services should lead the growth of the sector?

Because worldwide, the telecommunications

market is experiencing steady growth in the use of data services, at the heart of our strategy for the next few years are 4G data packages, mobile telephony, and ultra wide band.

I think there will be significant growth in such services as pay TV, mobile data, and high speed broadband, which represent significant growth opportunities for Vivo. Consumers will increasingly seek services that facilitate their daily lives, in both leisure and professional life. That is why we have invested in developing value-added services—VAS. In Brazil, we have over 80 such services and over 40 million active customers.

In the second quarter of 2015, data and VAS revenue increased by 33.5% year on year, to R$2.7 billion. In the first half of this year, VAS revenue totaled R$949 million—24.1% higher than in the same period in 2014.

What new technologies are likely to appear in the Brazilian market in coming years?

In future, everything will be connected: your refrigerator, your car, your home appliances, and your clothes. You will be able to remotely command your things. Your car will be connected, providing real-time information. This concept—the Internet of Things—is beginning to emerge.

To serve so many connections at the same time we need more network capacity, so the infrastructure will evolve, just as we witnessed the evolution from 2G to 3G and 3G to 4G. The network will evolve to 5G technologies. The future is therefore 5G, the Internet of Things, and digital services. There is also another paradigm shift coming with regard to consumption of video services. More and more people will want to watch video content whenever they wish on whatever device they choose. So there is growing demand for solutions that deliver the consumer nonlinear video programming—customizing the program schedule.

Connectivity remains at the heart of our business, but we also want to offer digital solutions that will make life easier for our customers, whether at leisure or at work.

There is a huge controversy about the prices of telecom services in Brazil compared to other countries. What is your view?

The tax burden makes telecom services in Brazil more expensive, and the tax complexity increases the cost of business. Taxes on services are high. In mobile telephony, for example, taxes take up 43% of net revenue.

According to SindiTelebrasil data, in 2014 the telecommunications sector had R$234 billion in gross operating revenue, 4.2% of GDP. Users of those services in 2014 paid R$60 billion in taxes, equivalent to 43.2% of the sector's net operating revenues.

Brazil is the champion in taxation among the 10 countries with the largest number of mobile accesses in the world. Our tax burden of 43.9% is 2.4 times more than Russia with 18%. In China, the world's largest market, the tax burden is 3%, in India, the second largest market, 12.2%, in the United States, the third largest market, 17.2%.

Society increasingly uses more information and communication technologies, for work,

In future, everything will be connected: your refrigerator, your car, your home appliances, your clothes. You will be able to remotely command your things.

health, education, or entertainment. Therefore, digital accessibility has become a priority for a country's social and economic development and for modernization of society. Reducing the tax burden would bring many benefits to people by integrating them into the digital environment, which would promote their social inclusion.

Is Brazil's mobile phone market mature? Does Vivo expect a new cycle of growth by selling new services?

After several years of strong growth, the Brazilian market for telecom and cable TV has recently entered a phase of moderate growth. Much of the growth in recent years was caused by demand from new segments of the population for telecom services and cable TV. Yet so far only 34% of households have broadband service and 28% have pay TV service. There is still potential for growth in segments that currently do not have these services.

On the other hand, our current customers are demanding faster speeds, larger data packages, and interactive services. Consumption of data increases every day and will not stop. We believe that future growth of the telecom market will come from a combination of these two types of customers. In the next few years, there will be a significant growth in services like mobile data, pay TV and high-speed broadband.

According to a study by the Brazilian Agency of Telecommunications (ANATEL), the government's proposed increase of 189% in the Telecommunications Inspection Fund rate could exclude 40 million Brazilians. What impact do you expect from higher taxes on telecoms?

The increase in taxes can dramatically impact company investment capacity and consequently harm consumers of services, which have become increasingly important in their personal and professional lives. The high tax burden also adversely affects consumers directly. Any increase in this tax rate can prevent expansion of the sector, significantly raise the cost to consumers of services, and reduce the capacity of operators to invest.

The National Broadband Plan did not take off as expected. Can it be revived to incentivize a new expansion cycle for the market?

All initiatives to democratize access to information and digital inclusion in Brazil are positive, especially because telecommunications services are becoming so important in peoples' daily lives and in the economy. But expansion of Internet access depends on many more factors than just expansion of infrastructure to provide the service. We must also reduce the barriers that limit the use of telecommunications services, particularly among families with lower incomes, such as the high tax burden on telecommunications services and on prices directly charged to the end user.