Brazil-U.S. Business Council

PATRI

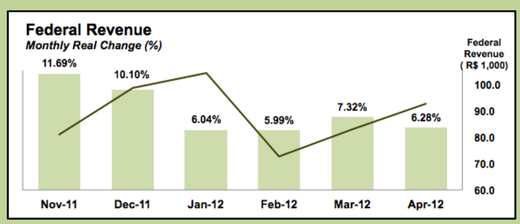
POLICY MONITOR

May 21 – 25, 2012

THE WEEK IN REVIEW

In response to the deterioration of the European sovereign debt crisis, Finance Minister Guido Mantega unveiled this week a **stimulus package aimed at boosting industrial output and consumption**. The new measures, which include tax cuts and subsidized credit worth BRL$ 2.7 billion, benefit primarily labor-intensive sectors such as vehicles, construction and capital goods. The Central Bank also cut bank reserve requirements for vehicle loans by about BRL$ 18 billion. According to Mantega, the international crisis affects the Brazilian economy and requires "invigorated efforts to preserve the growth rate." Anticipating the country will not grow 4.5%, as previously forecast by the Rousseff administration, Mantega said growth should be stronger in 2012 than in 2011, when Brazil grew 2.7%. In PATRI´s view, since the new measures do not address structural hindrances such as a high tax burden and red tape, it will probably not foster growth to the extent expected by the government. In order to maintain tax revenues, the administration will likely soon announce tax hikes for sectors such as cosmetics, perfumery and high-end home appliances, slowing down the consumption of these goods. In contrast to 2008, when the Lula administration first adopted anti-cyclical policies, today Brazil faces constraints such as increasing rates of delinquency in loan payments. The Central Bank informed that the default rate on loans rose 0.9% in March on a yearly basis. Interestingly, FGV, an academic and research center, reported that the Consumer Confidence Index (ICC) fell 1.2% in May, from 128.7 to 127.1, as **consumers are less optimistic about the current outlook**. The administration also announced that federal revenues amounted to BRL$ 92.6 billion in April, a real increase of 6.28% from last year due mostly to higher corporate profits. However, given the current scenario, tax collection should drop in the coming months.

Meanwhile, Sports Minister Aldo Rebelo released a new report showing **major delays in World Cup-related construction**. With almost two years until the soccer championship kicks off, only 5% of new stadium construction and transportation projects are finished. Another 54% are under construction and 15% are still being designed. "Given the complexity of its democratic structure, in Brazil it is necessary to meet a large number of legal requirements," said Rebelo. On the political front, in a bold and symbolic step on the eve of the Rio+20 Conference, **President Dilma Rousseff will veto parts of the recently approved Forest Code** on Friday (May 25th). By doing so, Rousseff, who currently enjoys a strong 77% approval rate, confronts the powerful agribusiness lobby in Congress.



Below, key policies that were tracked by PATRI during the week.

Energy & Environment

Forest Code

Overview

In the partial veto of the Forest Code by President Dilma to be announced on Friday (May 25th), the following controversial aspects will probably be cut out:

- The grant of partial amnesty to landowners who illegally cleared forests as early as 2008. This would, therefore, relax some of the legal requirements for reforestation for these areas
- Use of APPs (Permanent Preservation Areas) in mangroves
- Use of the Pantanal region
- Regulation of shrimp production/farming
- Legal reserve requirements for the Amazon, as well as its management and operation
- Use of APPs for agroforestry, ecotourism and rural tourism
- Use of APPs for small properties

Next Step

The administration should propose new legislation to Congress to fill legal gaps in the new Code.

Extra

Slave Labor

Overview

The House Plenary approved the constitutional amendment, (PEC) 438/01, which toughens penalties for landowners and others who force people into slave-like working conditions. The amendment also allows the government to confiscate without compensation property of anyone found to be using slave labor. Offenders will also be subject to penalties for using slave labor that are already in Brazil's penal code, including fines and jail terms.

Next Step

The constitutional amendment will be voted on in the Senate.

Tax & Investment

Land Acquisition by Foreigners

Overview

The Special House Subcommittee approved the report on land acquisition by foreigners. The following areas of the text are highlighted:

- Does not differentiate in the treatment of acquisition and leasing
- Stipulates that the principles of social function of the property should be observed
- Prohibits the acquisition and lease for indefinite duration
- Establishes that limits do not exceed one quarter of the surface of the municipalities where they are located
- Changes Law 9.393/96, which regulates the tax on rural properties
- Determines that taxpayers notify the Internal Revenue Service of registration information regarding each property, as well as any change concerning the temporary transfer of land use, rental or rural partnership
- Determines that restrictions do not apply to established Brazilian legal entities, even if established or controlled directly or indirectly by foreign nationals, except NGOs, sovereign funds of foreign countries or foundations
- Validates the purchase of lease of rural property by individuals or legal entities in Brazil, although in contradiction to the provisions of Law No. 5.709/71

Next Step

The approved report will be submitted to CAPADR (Committee on Agriculture, Livestock and Rural Development).

Incentives for Automotive and Capital Goods Sector

Overview

In order to stimulate economic growth, the Ministry of Finance and BNDES announced a package of financial and tax incentives for the automotive and capital goods sector. One measure is the reduction of bank reserve requirements to make vehicle loans cheaper.

Capital Goods: rates for lines of credit for the purchase of trucks and buses, capital goods, exports of capital goods and for the Proengenharia program, were reduced.

Automotive: IPI sales tax reduction for vehicles until August 2012. In return, the auto industry has pledged to announce special discounts on car prices and to maintain jobs in the sector. In addition to the tax measure, the Central Bank will reduce bank reserve requirements for vehicle financing. The government has also asked financial institutions for an increase in the number of installments and to reduce the down payment and interest rates on loans.

Consumer Credit: reduction of the IOF investment tax for loans to individuals from 2.5% to 1.5% per year. The measure aims to reduce the cost of consumer credit in a context in which public and private banks have already announced cuts in interest rates and spreads.

Next Step

Some measures have yet to be published in the Federal Registry.

Trade Facilitation

Drug Procurement

Overview

The Rapporteur presented a favorable position regarding Bill (PLC) 27/07, which establishes the requirements for procurement of medicine and pharmaceutical supplies. It provides that the bidding should meet the following requirements:

- Presentation of state and municipal sanitary license
- Evidence of authorization of company participating in the bid
- Evidence of authorization of company participating in the bid in cases of medicines or pharmaceutical supplies subject to special control regimes
- Evidence of product registration issued by the competent health authority
- Certificate of good manufacturing or distribution practices and production line of the drug under the contract bid or an equivalent certificate issued by the competent health authority
- Certificate of good production practices for supplies acquired directly from Brazilian producers or equivalent certificate issued by the competent health authority

Next Step

Bill will be voted by the CCJ (Senate Committee on Constitution and Justice) and then go to the Senate Plenary.

Countries that Subsidize Exports

Overview

The Rapporteur presented a negative position regarding Bill (PL) 2771/11, which allows the application of tariffs on products from countries that subsidize their export companies. According to the Rapporteur, the bill shows a concern in protecting the Brazilian market, but there are current laws that deal with the matter, as well as international agreements signed by Brazil.

Next Step:

The bill will be voted on by the CDEIC (House Committee on Economic Development, Industry and Trade) and then go to the CCJC (House Committee on Constitution, Justice and Citizenship).

IT and Telecommunication Tariffs

Overview

Camex (Foreign Trade Chamber) created a tariff exception for IT and telecommunication goods, lowering the import duty to 2% until December 31, 2013. The product list includes: portable machines for processing data used in management of reforestation control, timber industry, oil rigs, production and quality control of blast furnaces, among others.

Drawback

Overview

Secex (Foreign Trade Secretariat) extended until July 15th, 2012 the deadline to submit suggestions to the Public Comments for Ordinance No. 13/2012, which regulates the administrative handling of imports and exports, as well as drawback provisions and Ordinance SECEX No. 16/2012 on certificates of origin.

THE PULSE

A new study released by CNI (National Confederation of Industry) presents a dire scenario of the Brazilian industry. **Since 1996, the participation of imported consumption products doubled, from 10.1% to 21.1%.** The imported goods penetration coefficient increased for 17 of the 23 analyzed sectors. High increases were seen in the clothing, auto-parts and electric materials and machinery sectors. While these numbers paint a positive picture for both consumers and inflation control, it also indicates the increasingly competitive domestic environment faced by Brazilian products. The study also reveals that the general share of imports hit a record high in this period. The participation is calculated by the import penetration coefficient, which reached 22.2% in the past 12 months.

As for exports, the participation in industrial production maintained its upward trend. It represented 18.1% in the first quarter of 2012. This coefficient remains below the historical high of 20.4% in 2006. New measures within the Plano Brasil Maior (Greater Brazil Plan), such as interest rate reduction and exchange rate depreciation, take time to show results and, therefore, are the reason behind the hike in share of imports. With a general increase in imports, a devalued Real acts as a natural barrier to foreign competition at a time when more mature economies are in crisis and are reducing their prices to dump their products on the international market. The stronger dollar benefits the Brazilian economy because the domestic industry can compete better against imports. This week, CNI also published a survey depicting the negative outlook the industrial sector faces: drop in jobs for the 7th consecutive month, increase in inventories to not-desirable levels and the low use of installed capacity. The only exception to this alarming situation is that the industry is optimistic regarding export expectations.