Brazil-U.S. Business Council
Brazil Bulletin

Interview: Roundtable on investment in innovation with Rafael Lucchesi, Director of Education and Internet Technology for the National Confederation of Industries (CNI), Pedro Wongtschowski, member of the Board of Directors of the Ultra Group, and Luiz Antônio Elias, Executive-Secretary of the Ministry of Science and Technology

--"Innovation is the chief factor keeping companies, and countries, competitive in today's world."— Rafael Luccesi

Investment in innovative technologies has become a paradox in Brazil. Few companies invest but the breadth and complexity of investments has improved in recent years. Experts are hoping for a quantum leap, in both quantity and quality, beginning this year as a new public-private initiative gains traction. The Brazilian Research and Industrial Innovation Corp. (Embrapii) is due to expand its activities in 2014, based on a unique formula for cooperation involving companies, universities, think tanks and government agencies. Three prominent supporters of Embrapii recently spoke about its prospects at a seminar sponsored by the National Confederation of Industries (CNI). Excerpts follow:

- **Wongtschowski:** "Although it's the brainchild of the government, Embrapii is not an official agency. It's a non-profit entity. The board is made up of government and private representatives, with the private sector in the majority. It's essentially a private enterprise institute bringing together universities, think tanks and government agencies. These, in turn, go out into the marketplace looking for companies that need the kind of research Embrapii is structured to organize and deliver."

- **Lucchesi:** "So far, Embrapii has delivered research to 25 companies in areas as diverse as health, energy and agriculture. It's a new kind of strategy. It leverages private investment and reacts rapidly to corporate demands. It borrows personnel from government agencies and other entities. It doesn't have its own employees. Because it earns money from research contracts, it doesn't spend a dime of taxpayer money. We expect Embrapii to deliver research to as many as a hundred companies this year."

- **Elias:** "Some companies tend to put technology at the center of their investments. They tend to be the most successful. Reducing costs and improving productivity are crucial and investment in new technologies is the key."

- **Lucchesi:** "Innovation is the chief factor keeping companies, and countries, competitive in today's world. Innovation is practically a cultural attribute of the industrially developed countries. In Brazil, there has been a decline in investment in innovation. But the quality of projects developed by those companies that do invest has improved."

- **Wongtschowski:** "From 2008 to 2011, the percentage of manufacturers seeking government financing for innovation rose from 23% to 25%. The problem is that it's always the same companies. In other words, those who innovate, keep innovating; those who do not, fall behind."

- **Elias:** "What we're doing, in essence, is to harness all of the nation's research resources and make them available to companies so they can become more competitive."

Top News of the Week

Primary budget surplus gets off to a weak start in 2014. Brazil's public sector posted a weak R$19.9 billion primary budget surplus in January, down sharply from R$30.3 billion in January of 2013, the Central Bank said last week. The 12-month surplus sank to R$80.9 billion as of January from R$91.3 billion the previous month. As a percentage of GDP, the January figure represented a decline to 1.67% from 1.9% as of December. Brazil is committed to a primary budget surplus in 2014 of 1.9% and, thus, begins the year lagging behind the target. Economists noted that much of the problem was heavy January spending postponed from December precisely in order to meet last year's target, which was also 1.9% of GDP. Government spending in January rose 12% against the previous month. But revenues were also up in January, to the tune of 6.6%, offering hope that a stabilization in spending, combined with solid tax collections, can still produce on-target fiscal performance for the year.

Opposition PSDB faces triple threat from corruption investigations. The ruling Workers' Party (PT) is not the only one managing fallout from scandals at the start of this year's electoral campaign. The opposition Social Democratic Party (PSDB) has its own woes, with three separate investigations in course. Unlike the PT, however, the PSDB has tended to distance itself from those under investigation, while lauding efforts of prosecutors and judges. So far, none of the scandals has directly tarred any of the party's national figures. However, arrests, trials or sentencing ahead of October elections could damage the party as much as the so-called *mensalão* bribery case has hurt the administration of President Dilma Rousseff. Scandals involving the PSDB include the following:

- **The Minas Gerais *mensalão***. Federal prosecutors accuse former Minas Gerais governor Eduardo Azeredo of diverting state government funds to his re-election campaign in 1998. The campaign was ultimately unsuccessful. According to prosecutors, Azeredo utilized the services of advertising guru Marcos Valério as part of the scheme. Valério would later play a similar role in the *mensalão* scandal that marred the first term of President Luiz Inácio Lula da Silva. Elected to Congress in 2010, Azeredo resigned his seat in February in order to organize his legal defense and prevent embarrassment to PSDB presidential candidate Aécio Neves, who is also a former Minas Gerais governor.
- **The São Paulo subway cartel**. State prosecutors in São Paulo are investigating possible evidence that a cartel of international suppliers may have fixed bidding for equipment and services destined for the sprawling São Paulo subway and commuter train system. They say the cartel operated from 1998 through 2008 and was made possible by collusion with state government officials. The scandal covers three different state administrations, all of them headed by PSDB governors. Prosecutors have arrested six former officials in the scandal. Of the three governors—Mário Covas, Geraldo Alkmin and José Serra—only Serra has been mentioned by name as a target for investigators. Serra, governor from 2007 to 2010, has denied any knowledge of bid-fixing or other irregularities.
- **The Alstom case**. Both local and federal prosecutors in São Paulo have been investigating an alleged bribery scheme involving France's Alstom. According to prosecutors, Alstom paid some R$23.3 million in bribes to state officials during the period 1998 to 2003 in exchange for contracts to supply equipment for the modernization of electric generating stations in São Paulo. Prosecutors have arrested 11 former officials in the case. Neither of the São Paulo governors during the period—Covas and Alkmin—has been mentioned in the investigation.

Business News

Investment News:

Investments in Brazil by international **private equity** funds fell by 40% in 2013 to only $2.8 billion, according to the Emerging Markets Private Equity Association. The group represents 300 private equity funds with investments in emerging market countries around the world. Brazil still represented 65% of private equity investments in Latin America in 2013 but that proportion was down from 84% in 2012. Brazil has lost ground, in relative terms, to Mexico and Chile, the association noted. Economists cite a number of reasons for the decline in interest in Brazil. These include three years in a row of low growth, the persistence of 6.0% inflation, rising interest rates, political uncertainties in the face of 2014 elections and increasing foreign exchange risk, among others.

Company News:

South Korean ball-bearing manufacturer **Shilla Corp.** will invest R$100 million in a Brazilian plant this year, the company announced last week. The factory will be the company's first outside of Asia. Located in the São Paulo industrial city of Tietê, the plant will begin operations in 2015. Shilla will supply ball bearings to makers of wind turbines. Later, the company intends to expand its production to supply industries such as construction and oil and gas.

Brazilian Calendar

Tuesday, March 11, Brazilian Census Bureau (IBGE) release of monthly industrial production figures, Rio de Janeiro

Wednesday, March 12, Brazilian Census Bureau (IBGE) release of monthly IPCA inflation data, Rio de Janeiro

Thursday, March 13, Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro

Indicators

Foreign exchange rate: **R$2.35 = $1.00**

Total **lending volume** in the Brazilian financial system advanced a mere 0.1% in January against the previous month to R$2.717 trillion, the Central Bank said last week. Credit lagged inflation, and other indices, on seasonal factors, with businesses shuttered for summer holidays and consumers paying down Christmas season debts. Lending was up 14.8% against January of 2013. Average interest rates rose in January to 20.7% from 19.7% as of December, reflecting continued Central Bank hikes in the base interest rate. Defaults were steady at 3.0% of total loans. As in past months, state-run banks tended to increase their share of total lending, this time reaching 51.6%, up from 51.2% as of December.

Brazil posted a February foreign **trade deficit** of $2.12 billion, down from $4.07 billion in January but still the largest deficit for the month of February since 1994. The deficit for the first two months of the year was $6.183 billion, up from $5.319 billion for the same period in 2013 and the largest January-February trade deficit in history. Both imports and exports rose during the first two months of 2014 but imports at a much faster pace. Crude oil and oil products were the biggest items pressuring the import side of the ledger, reflecting sluggish development of offshore oil fields and a period of maintenance at oil refineries. Deficits are typical at the beginning of each calendar year. The balance usually begins to tip in April as the annual grain and oilseeds harvest kicks off.