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BRAZIL BULLETIN INTERVIEW: Edson Pinto, Tax Attorney and Federal University of São Paulo Law Professor – "Today, we have an ad hoc culture. To modernize, Brazil needs to adopt a planning culture." Brazil's tax structure has become "a swampland of rules, exceptions and loopholes" since adoption of the 1988 Constitution, according to Tax Lawyer and Professor Edson Pinto of the Federal University of São Paulo. Nevertheless, Pinto is optimistic that, long-term, Brazil will be able to clear out the Augean Stable represented by its tax laws, amendments and regulations. He discussed tax reform in a recent interview. Excerpts follow:

- On Brazil's antiquated tax system: "Brazil created a complex tax system with the 1988 Constitution. The politicians who control it dole out the exceptions and loopholes, exacting a political price at every stage. Worse still, the system is open to corruption."
- On tax reform: "The first step in any tax reform would be to simplify the system, to make it more transparent. That alone would reduce the arbitrary character of the system and its inherent corruption."
- On chances for tax reform: "I'm optimistic Brazil will someday reform the tax system, but the culture has to change. Today, we have an ad hoc culture. Brazil needs to adopt a planning culture. Tax revenues need to be matched with spending needs, including long-term development projects.
- On state governors and tax reform: "State governors try to block tax reform because they believe they will lose revenue. Under the current system, more revenue goes to those governors and mayors who are the most adept at exchanging political favors. If we had a system based on planning, the most revenue would go to those governors and mayors who come to the table with the best drawn plans for development."
- On the current division of tax revenues: "Under Article 152 of the Constitution, there is an automatic distribution of revenues among the three levels of government. With guaranteed revenues in hand, mayors and governors are free to spend the money pretty much as they wish. There is virtually no oversight."
- On the complexity of the Brazilian tax code: "Brazil has 85 different taxes. We pay taxes, often indirectly, on everything we consume, including services. One of the credibility problems for the Brazilian tax system is the fact that certain taxes are earmarked for certain purposes but then governments go ahead and spend the revenues on whatever they want. You pay a road tax to help maintain roads but then the money is spent on something else. We end up paying a lot in taxes but we

> still have to supplement government services with our own health, education, transportation and even security services. It's a lot to ask."

Central Bank hikes base rate for fifth consecutive time; Selic hits 12.5%. The Brazilian Central Bank last week hiked its Selic base rate for the fifth consecutive meeting. The aim of the monetary tightening cycle is to fight down persistent inflation. The bank hiked Selic by a quarter-point to a towering 12.5%. Despite higher rates, inflation is still running at a worrisome 6.7%, up from 5.9% at the end of 2010. However, language used in the Central Bank's brief statement last week suggested that the current tightening cycle may be ending.

First-half steel output, exports rise on higher international prices. Steel output and exports rose in the first half of 2011 on robust domestic demand for durable goods, government investment in infrastructure projects and rising international steel prices, the Brazilian Steel Institute (IABr) said last week. First-half crude steel production was 17.7 million metric tons, up 8.2% from the first half of 2010. Higher international prices helped boost steel exports while making imported steel less attractive. First-half exports reached 5.6 million metric tons, up 32.7% from the year-earlier period. Higher international prices meant revenues from first-half exports soared 69% to $4.3 billion. But imports in the first half fell 37% from a year earlier to only 1.7 million metric tons, the institute said.

Central Bank tightens rules on provisioning for credit card debt. The Brazilian Central Bank tightened rules on credit again last week, part of a year-long drive to fight down inflation and arrears with stricter credit rules. The latest rules change obliges banks to raise provisioning on payroll-backed credit card lending to 150% of expected arrears levels from a previous 75%. The new order puts payroll-backed credit lending on a par with other forms of payroll-supported credit. The Central Bank said the new rule was designed "to discourage long-term payroll-backed credit card financing in line with prudent risk management." Brazilian lending volume has continued to increase this year despite higher taxes and increased restrictions. Total lending volume as of May was R$1.8 trillion, up 10.4% from May, 2010. Credit card operations, as of May, represented about 7% of total lending volume.

Petrobras scales back multi-year investment plan, will sell assets. State-run energy giant Petrobras last week agreed to scale back ambitious 2011-2015 investment plans and will even sell some assets in order to guarantee higher dividend payments to the federal government. The company last week announced a multi-year investment program of $224.7 billion. The announcement came after months of negotiation with the Dilma Rousseff administration. In the end, company managers agreed to scrap planned investments of more than $40 billion. They also agreed to sell assets worth an estimated $13.6 billion in order to boost dividend payments and help Brazil's government meet primary budget surplus targets at a time of rising inflation. Petrobras officials admitted they were forced to scale back investments, in part, because of a government-mandated freeze on price hikes for the oil derivatives Petrobras sells on the domestic market. The price freeze is also part of the government's anti-inflation drive.

Investment News: Brazilian capital market activity rose 12.5% in the first half of 2011 despite sluggish economic growth and rising interest rates, the **Brazilian Capital Markets Associatio**n (Anbima) said last week. Total issuance of shares and debt in the first half was R$57.8 billion, up from R$51.3 billion in the first six months of 2010. Companies continue selling both debt and shares because of prospects for sustainable, long-term economic growth, Anbima said. *** Mining giant **Vale** last week announced investments of R$3.5 billion over the next four years in logistics for its São Paulo operations. The investments will focus on ports, warehouses and rail links in the state. *** Lending by the **National Development Bank** (BNDES) declined 6% in the first five months of 2011 to R$43.5 billion, the bank said last week. BNDES officials said they were being more selective in lending as part of a broad government effort to cut back on credit availability and reduce inflation.

Company News: U.S.-based financial exchange company Intercontinental Exchange Inc. (**ICE**) last week announced the purchase of a 12% stake in Brazil's main financial clearing house Cetip SA. ICE will pay $512 million for the stake. ICE purchased the shares from international private equity firm Advent and from Brazilian private bank Itau. *** U.S.-based **Dow Chemical** and Japan's **Mitsui and Co**. last week created a new Brazilian joint venture that will use sugarcane to produce both fuel and polymer derivatives. The companies did not immediately release financial details of the arrangement. The joint venture will turn Brazilian sugarcane into ethanol for fuel and polymers for use in the packaging, hygiene and medical industries.

Indicators: Federal **tax revenues** rose sharply in June on stepped up collections of personal income and corporate taxes, the government said last week. June revenues were R$82.7 billion, up a stunning 23% from June of 2010. First half revenues reached R$465.6 billion, a rise of 12.7% from the same period a year ago. ***** Brazil's **unemployment rate** continued to dive in June, this time hitting 6.2% from 6.4% a month earlier. Unemployment in June of 2010 was 7.0%. Average incomes also continued to rise in June, hitting R$1.579 per month, up 0.5% from May, the Brazilian Census Bureau (IBGE) said last week. ***** Brazilian **domestic air traffic** rose 19.5% in June against the same month a year earlier, the Civil Aviation Authority (Anac) said last week. Domestic traffic reached 6.21 billion passenger/kilometers. TAM remained the leading airline with a 41.7% market share.

Other News: The **Planning Ministry** last week raised its forecast for 2011 federal tax revenues to R$732 billion from a previous forecast of R$730 billion, saying the target for this year's primary budget surplus of R$117.9 billion was virtually assured. The ministry held to its previous forecast of 4.5% economic growth this year but hiked its inflation forecast to 5.8% from a previous 5.7%.

Brazilian Calendar for Week of July 25:

- **Tuesday, July 26 -** Brazilian Central Bank release of current account data, Brasília

- **Wednesday, July 27 -** Brazilian Central Bank release of lending volume data, Brasília
- **Friday, July 29 -** Brazilian Central Bank release of primary budget surplus figures, Brasília

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R$1.56 = $1.00