Brazil-U.S. Business Council

PATRI Public Affairs

POLICY MONITOR

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The Week in Review

On The Economic Front

Drought: The worst drought in four decades is threatening hydroelectric dam reservoirs and domestic water supplies. According to the national grid operator (ONS), on February 9 reservoirs fell to 37.6 % of maximum capacity in the heavily populated Southeast and Midwest regions. Despite the critical water level, the administration has made assurances that there will be no energy shortages. Unlike the 2001-2002 water crisis, Brazil today also counts on gas-fired thermal plants to cope with growing energy demand. However, the drought could impact the cost of energy for both businesses and households. If rainfall does not improve in the next week, São Paulo, among other states, could restrict water use.

Grain crops: President Dilma Rousseff attended the 2013/2014 soy harvest official kick off in the state of Mato Grosso. Despite the drought, which has affected the coffee crop, the national food supply agency Conab forecasts record grains output of 193 million tons. “This is a victory for the agribusiness [sector] in Brazil”, Rousseff said, apparently already engaged in her re-election campaign.

On The Political Front

Cabinet Reshuffle: Following last week´s first phase of the cabinet reshuffle, Minister of Development, Industry and Foreign Trade (MDIC) Fernando Pimentel left to run for governor of the state of Minas Gerais. Mauro Borges, the President of the Brazilian Agency of Industrial Development (ABDI), is expected to step in this Friday, on an interim bases. Also, Paulo Cafarelli, a financial technocrat and former Banco do Brasil Vice-President for Wholesale, International Business and Private Banks, stepped in as the Finance Minister Executive Secretary. Cafarelli is said to have been chosen by Finance Minister Guido Mantega to improve administration ties with the private sector. Dyogo de Oliveira, who worked temporarily as the Executive Secretary, stepped in as Deputy Executive Secretary.

Lula in NY: Former President Luiz Inácio Lula da Silva and former president Bill Clinton met Tuesday in New York to discuss a possible partnership to fight hunger in Africa. Lula also gave a lecture to American investors. Highlights: The market’s perception of Brazilian vulnerabilities is exaggerated, and foreign investors should not be afraid to invest in Brazil.

Strikes: On February 11, the Federal Police went on a 24-hour strike in 24 states and the Federal District. Post officers have also been on partial strike since January 29. As the World Cup approaches, other public officials, such as airports ground personnel, could also go on strike, a traditional form of labor posturing during election years.

Task Force

Defense and Security:

» **Antiterrorism Bill**: Following the outrage over the death of a cameraman covering a protest in Rio de Janeiro, bill PLS 499/13, which seeks to define and set punishment guidelines for acts of terrorism, has gained some traction in the Senate. President of the Senate Renan Calheiros (PMDB/AL) has indicated that the bill could be voted on soon, after an agreement is reached on the definition of terrorism. The current bill would set incarceration at between 15 to 30 years for terrorist crimes and between 24 to 30 years for those resulting in death. The ruling Workers Party (PT) is against the current text, saying it is vague and leaves room for misinterpretation in classifying violent crimes that occur during protests. Next step: Rapporteur Eunício Oliveira (PMDB/CE) will produce a clean bill that should be voted on by the full Senate.

» **Navy new South-Southeast brigade**: The Ministry of Defense published ordinance Nº79/MB that creates the new organizational structure for the South-Southeast Naval Patrol Brigade (ComGptPatNavSSE). The brigade is a military organization with administrative autonomy, headquartered in the city of Santos / SP and subordinate to the 8th Naval District Command.

Energy and Green Technology:

» **Solid Waste**: A new Senate sub-committee on solid waste was established to conduct oversight and write a draft regulatory bill. The sub-committee also approved its own work plan to review the current National Solid Waste Policy. Senator Vanessa Grazziotin (PCdoB/AM) was nominated rapporteur.

Innovation:

» **Internet Framework Bill**: The House floor vote on the Internet Framework Bill (PL 2126/11) was postponed because of a lack of consensus between the administration and its main ally in the governing coalition, the PMDB. The PMDB alleges that the current bill is not business friendly, and if approved, could discourage future investments in Brazilian Internet infrastructure. The bill has also been used by PMDB to bargain for more leverage in the cabinet reshuffle negotiations. Next step: Despite the political disagreements, the bill could be voted on next week, as the rapporteur read it out during a plenary session in the House, indicating that the voting process is moving on. If approved by the House, it will be sent to Senate committees for discussion, followed by a floor vote.

» **Cyber Security**: The Inter-ministerial Working Group on Cyber Security (GTI de Segurança Cibernética) held its first meeting to define a working plan that would survey critical national issues, such as the need for specific legislation to increase Internet security in Brazil. The working group comprises 14 different ministries and federal regulatory agencies such as the Secretariat of Strategic Affairs, and ministries of Defense, Foreign Relations and Communications. Next step: The Working Group is expected to produce a strategic plan within seven months to be presented to President Rousseff.

Tax and Investment:

» **Internet advertising taxation**: Communications Minister Paulo Bernardo said that foreign Internet companies that sell advertising in Brazil should be paying more taxes. Quote: “If there is a company that has 70% of market share, we may have to discuss it.” At the request of President Rousseff, the Secretariat of the Federal Revenue has created a task force to investigate internet service companies. Also, both the National Telecommunications Agency (ANATEL) and the National Film Agency (Ancine) are working on a new model of taxation for internet companies.

Trade and Regulation:

» **Cotton Case:** CAMEX has rescheduled its next meeting to discuss Brazil’s possible retaliation against the U.S. to February 19. But it is likely that any final decision will be postponed beyond the end of February while the United States and Brazil continue consultations over implementation of specific provisions in the Farm Bill.

» **Tax Reform**: The Select Joint Committee approved the work timetable suggested by the Rapporteur Eduardo Cunha (PMDB / RJ) to analyze the clean bill on the Provisional Measure (MP) 627/13. It should be presented to the committee by February 19th. According to the Rapporteur, the clean bill is almost ready to be voted on following discussions with both the Ministry of Finance and the Secretariat of the Federal Revenue. The MP alters important provisions of the Brazilian taxation system, such as basic accounting rules that could potentially affect big companies operating in Brazil.

» **Public Procurement Legal Framework**: Fifty-five amendments were offered to the draft bill PLS 559/13 that draws on the report presented by Senator Katia Abreu (PMDB/TO). It follows recommendations made by experts in public procurement to reform the General Procurement Law (Lei 8.666/93). The bill encourages the use of electronic trading and maintains the practice of using “tenders and auctions” as mandatory procedures for public procurement. Next step: The bill is expected to be sent to Senate committees for discussion, followed by a floor vote.

» **Provisional Measures**: Select Committees have been installed this week to analyze nine Provisional Measures submitted by the government at the end of 2013: MP 629/13 Export Promotion; MP 630/13 Special Procurement Regime; MP 631/13 Public Calamity Funding/Drawback; MP 632/13 Public Servants Pay; MP 633/13 subsidies for financial operations closed by 12/31/14; MP 634/13 tax cuts for biofuels imports; MP 635/13 Crops Insurance benefits; MP 636/13 rural settlers debt relief; MP 638/14 Car industry innovation stimulus.

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The Pulse

The year ahead: despite increasing challenges, Brazil is in better shape than most emerging markets

Although the presidential campaign has not yet been formally launched, Brazilians are already splitting their collective attention mostly between the World Cup preparations and the prospects of who will be their next president. Dilma Rousseff is still the front-runner, but the latest economic indicators and the business environment have not been supportive. Industrial output fell last year (with an especially sharp decline in December); the trade deficit for January was the worst since 1991; in 2013, the government had the largest budget gap in four years; fears of rising inflation continued to grow; and the inclusion of Brazil among the "fragile nations" by most international analysts has probably deterred foreign direct investment.

There is little doubt that Brazil faces a challenging economic policy environment during the election year. Resuming robust economic growth in the short term will be difficult given declining global demand for Brazilian commodities and the need for more restrained public spending and tighter monetary policy in the face of nagging, but manageable, inflation and the rising budget deficit. Nonetheless, economic fundamentals are expected to remain stable over the middle term, policy adjustments have begun to some extent, and public policy has turned to increased investment in infrastructure.

Indicators of External Vulnerabilities (%)

Country	Short term debt/ reserves	Total reserves/ total foreign debt	Total reserves/ months of imports
Brazil	8.73	84.72	12.78
India	31.07	79.25	5.90
Indonesia	39.68	44.25	5.60
Turkey	84.60	35.31	5.47
South Africa	54.98	36.86	4.51

Sources: World Bank / Carta Capital

While there is still some vulnerability to external economic conditions, most notably the rising US dollar relative to the Brazilian Real, the depreciated exchange rate should eventually help make Brazilian exports more competitive. Brazil's large foreign exchange reserves also provide a solid cushion against potentially volatile capital markets. In summary, Brazil is still in better shape than most emerging markets to which it has been recently compared. The incoming president, whether it is Rousseff, Neves, or Campos, will have the tools to mitigate most of the current problems and rebuild internal and external confidence on Brazil.

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