

The Week in Review

On the Political Front

Bilateral Relations

Brazil's Minister of Development, Industry and Foreign Trade, Armando Monteiro, met this week with U.S. Ambassador Liliana Ayalde in Brasilia, to prepare for his official visit to the United States scheduled for February 11-13, 2015. This is the first trip Monteiro will make to the United States as trade minister for the new administration. In Washington, Monteiro will meet with his counterpart, U.S. Secretary of Commerce Penny Pritzker, and other U.S. government authorities. The purpose of the meetings is to discuss issues that might lead to expanded trade between the two countries. Monteiro's visit will also serve to prepare for President Dilma Rousseff's planned visit to Washington, which may occur in September.

Petrobras

On Wednesday, Petrobras confirmed the resignation of its president, Graça Foster, and five directors of the state-owned oil company. Petrobras stock jumped after the announcement. Board resignations come in the middle of a severe crisis in the company caused by a corruption scandal. The new directors will be elected during the next meeting of the executive board, scheduled for this Friday.

House Probes

Just three days after Congress' return from recess, the House of Representatives received five requests to initiate Parliamentary Commissions of Inquiry (CPI), congressional bodies used to investigate specific issues or possible government wrongdoing. On Tuesday, representatives from the opposition in the House collected 182 signatures, 11 more than required, to formally create the first CPI in the House to investigate allegations of corruption and embezzlement in Petrobras. House President Eduardo Cunha (PMDB/RJ) read the request on the House floor and formally installed the CPI. Party leaders will have a deadline of up to five regular sessions to present the names of committee members. According to one PSDB leader, Carlos Sampaio (SP), who filed the request, one of the first actions by the opposition in the CPI will be to retrieve all of the evidence gathered by the Petrobras joint probe which ended in December 2014, including the records of Operation Lava Jato, the colloquial term used for the Petrobras scandal. The other four CPI requests would focus on: 1) the publication of election polls and their impact on election results since the 2000 election campaign; 2) allegations of irregularities committed by private health plans; 3) causes of violence in Brazil and proposed measures to reduce them; and, 4) causes of violence against black and poor youths in the country.

New Secretary for Strategic Affairs

On Wednesday, President Rousseff announced the first change in ministries. Mangabeira Unger is the new Secretary for Strategic Affairs, replacing Marcelo Neri, who was minister during Rousseff's first term. Unger returns to the Strategic Affairs Secretariat where he was Minister from 2007 to 2009, during former President



Lula da Silva's administration. In 2009, Unger left Brazil to resume his post as a professor at Harvard University.

Task Forces

Trade

Price Setting on the Sugar and Ethanol Industry: On Wednesday, the first Panel of the Federal Supreme Court (Supremo Tribunal Federal – STF) decided that the government's practice through the Institute of Sugar and Alcohol (Instituto do Açúcar e Alcool – IAA) of setting prices below the market rate for sugar and ethanol is an obstacle to the free exercise of economic activity and undermines the principle of private sector initiative, granting a sugar and ethanol plant the right to compensation. The IAA was created in 1933 but was terminated in 1990. Although price setting no longer exists, companies that suffered from the practice have been fighting in the courts since the late 1980s. It is estimated that approximately 290 companies were affected by that policy and could be eligible for compensation at a cost of BRL\$ 107 billion to the government.

Tax & Investments

State Taxes on E-Commerce: On Tuesday, the House of Representatives approved the second round of voting on the Constitutional Amendment Proposal (*Proposta de Emenda à Constituição* - PEC) 197/2012. The amendment would alter the ICMS tax collection for interstate e-commerce transactions. The ICMS is the major source of revenue for states. Currently, the ICMS for e-commerce transactions is collected at the state of origin. If the amendment is approved, the collection of the ICMS tax would be transferred to the state of destination over a five-year period (2019). To be enacted into law, the constitutional amendment must survive another round of votes in the Senate, and if unamended, would then go directly to President Rousseff's desk for her signature.

Provisional Measure 668: On Monday, Provisional Measure (*Medida Provisória*) 668/15 covering PIS/Cofins tax increases for imports, the fourth tax measure announced by Finance Minister Joaquim Levy, was published in the Official Gazette. There is a six-day period to offer amendments on the PM, starting Monday, February 2nd. This amendment will follow the 90-day window principle and not take effect until May 1st. According to the PM, PIS/Cofins for imports will be raised from 9.25% to 11.75%. Also, fees on incorrect offset tax credits will be revoked and the use of additional tax credits prohibited.

IPI on Capital Goods and Computer Products: The Chamber of Foreign Trade (Câmara de Comércio Exterior - Camex) reduced the Tax on Industrial Products (*Imposto sobre Produtos Industrializados* – IPI) for 435 capital goods, from 16% to 2%, and 10 computer products, from 14% to 2%. According to the Chamber, these benefits will be used for companies that plan investments of US\$ 1.4 billion in Brazil. The tax reductions are intended to stimulate investment in order to expand and restructure goods and services sectors. The main sectors that will benefit from the change are capital goods, food, wood and furniture, petrochemicals, cement, and construction.

Healthcare

Bill on Tax Incentives for Prostheses: On Monday, Bill 24/15 (*Projeto de Lei* – PL) was introduced in the House. The bill would allow deductions of up to 5% from income tax returns on the purchase of prosthetic products. The deduction would apply for non-governmental organizations (NGOs) and civil society organizations of public interest (OSCIP), with the proceeds used to provide support to low income households. The covered products include hearing aids, prosthetics, and wheelchairs. To be approved, the bill needs to be passed by three House committees and then be considered by the Senate.

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The Pulse

President Rousseff Must Now Rely on the PMDB

With the new speakers of the House and the Senate both members of the PMDB, President Dilma Rousseff became, for the first time, effectively politically hostage to her major coalition party constituency and the largest political party in Brazil. The PMDB also holds the vice presidency of the Republic, the largest number of seats in both houses of Congress, seven state governorships—the most of any party—and several municipal governments.

PMDB cooperation, therefore, is crucial for Rousseff's government to succeed. However, the party is far from being a coherent and unified bloc. Its ranks comprise politicians of varied ideologies and interests. Traditionally, the PMDB supports whichever party holds the Executive Branch and only gives up such support when the party in power becomes unsustainable.

President Rousseff's success rests on her restoring credibility in her second term by orchestrating an economic recovery based on a sizable, immediate, and politically costly fiscal adjustment. The goal is to achieve a primary surplus equal to 1.2% of GDP by the end of 2015. This target implies a larger financial commitment than previously estimated because the final figures for the 2014 government accounts turned out to be much worse than had been estimated.

This means that Rousseff's administration will have to take several unpopular measures that could end up reducing social benefits, adjusting public service tariffs, making deep budget cuts, raising taxes, and delaying needed investment. Several of these measures will require action by Congress. Budget cuts and tax increases already implemented are only the beginning, and expectations are that more will be seen soon after Carnival, but not necessarily before then.

The PMDB is likely to be difficult to manage for President Rousseff. On an issue-by-issue basis, it will gauge public opinion and operate to its political advantage. Its members have already initiated Parliamentary Inquiries into a number of issues, including the Petrobras scandal, which will not put the government in a good light. The fact that the new Speaker of the House, Eduardo Cunha, is practically Rousseff's nemesis is significant, but as with most of the PMDB leaders, he is a consummated political professional. If necessary, he will reconcile and support Rousseff, but could also end up hurting her as well.

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