

The Week in Review

On the Economic Front

Energy and Water Crisis

On Friday, Minister of Mines and Energy Eduardo Braga (PMDB/AM) participated in a general hearing requested by the House of Representatives (*Comissao Geral da Camara*) in order to discuss the current water and energy crisis. The minister attributed the crisis to hydrological and climate changes (the rainfall level for the month of January was the worst in recent memory). He emphasized that even with reservoirs at critical levels, the government is maintaining the electricity supply thanks to a powerful and diverse system. Braga did not address issues such as possible blackouts, hikes in energy tariffs, and potential measures that could be adopted in order to solve the water problem in critical regions such as the southeast and mid-west of Brazil.

On the Political Front

Petrobras

General Prosecutor Rodrigo Janot presented an order to Supreme Court (*Supremo Tribunal Federatl - STF*) to investigate 54 politicians for alleged involvement in embezzlement and inflated contracts with Petrobras. Minister Teori Zavascki, chair of the so-called Operation Lava Jato, must approve the investigation and grant permission to disclose the names of those involved. Although the names included in the list are still unknown, it has been said that they are parliamentarians, leaders of allied parties of the Government and opposition, as well as governors. Statements made to the federal courts by former manager of Petrobras Paulo Roberto Costa revealed that Senate leader Renan Calheiros and House leader Eduardo Cunha are listed among alleged beneficiaries of the scheme. Calheiros and Cunha, both members of the opposition Brazilian Democratic Movement (PMDB) party, have denied any involvement in the scandal.

Congressional Committees

The House and Senate installed most of their standing committees this week. The House of Representatives installed 22 out of 23 standing committees and elected their presidents (chairpersons) for one-year terms with no possibility of reelection. The distribution of committees' presidencies follows the criterion of proportionality, based on the size of party blocks formed at the beginning of this legislative session (February 1). The Senate installed 7 out of 11 presidents for its standing committees, each with a two-year term. Once each committee has all presidents and members defined, it can begin its work.

Agricultural Subsidies | WTO

On Wednesday, a confrontation between Brazil, Argentina, and India on one side, and the United States, Australia, and other developed countries on another, again demonstrated how difficult it still is to complete negotiations for global agricultural trade liberalization in the World Trade Organization (WTO). As usual, on the agenda were discussions on domestic subsidies for agriculture. In the WTO's Agriculture Committee, the



Cairns Group, where Australia's leadership brings together various developed agricultural exporters, presented data showing that agricultural subsidies generally increased between 2001 and 2012, but growth in developing nations was higher – 19.3% of its agricultural production, versus 12.4% in developing countries.

Developing nations argued that the Cairns Group data was improperly calculated, since subsidies from the “yellow category” (those that are more market distorting and need to be reduced) were not included, having been transferred to the “green category” (which according to WTO rules, are allowed to help incipient producers, conservation of landscape, or even agricultural research). According to them, the category swap was done mainly by misusing the traditional and cultural protection flag.

Task Forces

Trade & Regulation

Energy Rate Increase: On Monday, energy tariffs were increased by 24.2%. In Brazil, the “red flag” category used by the Brazilian government was raised from BRL\$ 2.50 to BRL\$ 5.5 for every 100kWh. The flag system was created by the National Agency of Electric Energy (*Agencia Nacional de Energia Eletrica - ANEEL*) and uses three flag categories: green, yellow, and red. Green is used when there is a favorable condition for energy generation, yellow when conditions are somewhat unfavorable, and red in difficult energy scenarios. This was an extraordinary tariff increase approved by ANEEL, but ordinary increases are still planned to happen this year, which means that energy prices are likely to rise again.

Truck Drivers' Law: At the beginning of the week, President Dilma Rousseff signed the new truck drivers' law. The modified legislation was one of the Brazilian trucker drivers' demands, who were on strike and blocked several roads in the country last week. Another one of the truckers' demands included lowering the price of diesel fuel, which was increased by the government as part of the austerity measures. The effort was unsuccessful. According to the president's general secretary, the country's highways should be back to normal after this new agreement is implemented. This new legislation will take effect on April 17, 2015. Highlights include:

- » **Working hours:** 12-hour working days (8 + 4 overtime hours), instead of 10 (8 + 2 overtime hours);
- » **Maximum of continuous driving hours:** Now for every six straight driving hours, the driver must rest for at least 30 minutes. In the previous law, the drivers needed a 30-minute break for each four hours at the wheel;
- » **Suspended axles:** Empty cargo transport vehicles will not pay toll rates on suspended axles;
- » **PROCARGAS:** Creation of the Programme of Support for the Development of the National Cargo Transport (*Programa de Apoio ao Desenvolvimento do Transporte de Cargas Nacional - PROCARGAS*) to stimulate the development of national ground load transportation activities;
- » **Drug testing:** Professional drivers will be required to submit to drug testing at the time of their hiring and/or lay-off;
- » **Rest areas:** The Federal Government will adopt measures to increase rest areas for professional drivers on Brazilian highways. One of the actions to be implemented is to include specific clauses demanding the construction of rest sites with highway concession contracts.

Healthcare

Prostheses and Orthoses Investigation: On Wednesday, President of the House Eduardo Cunha approved the creation of a Parliamentary Investigation Committee (*Comissao Parlamentario de Inquerito - CPI*) to investigate pricing and distribution cartel of prostheses and orthoses, the artificial creation of demand and the misuse of medical services for private interests. The CPI will likely focus its investigation on:

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- Finding those responsible (manufacturers, importers, distributors) and participating parties (doctors, clinics, hospitals, and legal actors) in the scheme
- Investigating how the scheme is carried out (illegal means of co-opting the public service / private healthcare marketing)
- The consequences and the damages of these practices caused to health systems and patients

Tax & Investment

Payroll Exemption Provisional Measure: On Tuesday, Congress refused an executive order that was an important part of the fiscal adjustment plan. Provisional Measure 669/15 (*Medida Provisoria* - MP) was returned to the Executive Branch by Senator Renan Calheiros (PMDB/AL), who is also president of the National Congress. Since ratification of the 1988 Constitution, this is only the second time that an MP has been returned to the Executive Branch. This MP refusal demonstrates an unhappy PMDB, which composes the ruling base that is less willing to cooperate with Rousseff's new economic austerity measures. This is also a sign of a more independent legislative branch.

The Senator argued that the MP was unconstitutional and would cause legal uncertainty for the country by invalidating a previous Provisional Measure, MP651/14, which was signed into law at the end of last year. This previous MP, among other things, created tax measures intended to stimulate national industry and the capital markets such as the continuation of payroll tax relief and its extension to the retail sector. The payroll tax benefit entailed that businesses substitute the social security contribution equivalent to 20% of the payroll with a fixed tax between 1% and 2% of gross revenue. This maneuver by Congress may delay the fiscal adjustment laid out in the MP for at least 90 days and cost the government at least BRL\$ 2.6 billion.

The rejected Provisional Measure would have increased the social contribution tax to 2.5% or 4.5% of gross revenue. According to the Brazilian Constitution, Provisional Measures dealing with tax issues only take effect after a 90-day window to allow affected parties time to adjust to changes in tax rates and rules.

In response to Senator Calheiros' action, President Rousseff apparently will send to Congress a bill, under constitutional urgency, that has the same content as the MP that was rejected.

Reintegra Rates: On Friday, the Reintegra program for the years 2015-2018 was amended through a presidential decree. Reintegra is an export tax credit program that returns a portion of the exported value of industrial products to companies through credits to the PIS and Cofins federal taxes. The tax credit is calculated over the income earned from the exported good. The percentages of the tax credit established for companies for these years are:

- » 1% between March, 1, 2015 and December, 31, 2016
- » 2% between January, 1, 2017 and December 31, 2017
- » 3% between January 1, 2018 and December 31, 2018

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The Pulse

Fiscal Adjustment Target of Brazilian Politics

President Dilma Rousseff has suffered successive rounds of defeat in both Houses of Congress in the two months since her second term began at the start of the year. Although it may appear as if her administration could be on the brink of a total collapse, this may not be the case; Brazilian politics is a complex and unpredictable affair.

The speakers of both the House, Eduardo Cunha, and the Senate, Renan Calheiros, are leaders in the PMDB. PMDB is the largest coalition party, and also the party of Vice President Michel Temer, but both speakers have been behaving more like opposition leaders, blocking many of President Rousseff's key legislative initiatives. There is likely more than one reason for this opposition.

First, they may be trying to disassociate themselves from legislation needed to achieve a large and highly unpopular fiscal adjustment. Second, they may also be trying to establish a political hedge against their own serious political problems. Both speakers are believed to be on the list of high-level politicians who may be investigated for alleged misdeeds in the Petrobras kickback scandal.

It is possible that they may also be positioning themselves against President Rousseff as a way to encourage her to provide some political support, if not cover, during the upcoming investigation. Cunha has never been a supporter of Rousseff and Calheiros, although more of an ally, may also be sending a hard message to the Executive Branch about the investigation. In either case, their legislative tactics may be viewed as a warning that support for her agenda may require something of quid pro quo.

The latest legislative rebuffs have raised doubts about the ability of President Rousseff to move the fiscal agenda forward. The fiscal adjustment, however, may not be at risk. As discussed in Valor Economico this Thursday, much of the fiscal plan does not require action by the Congress. Of the potential BRL\$111 billion already announced and hinted at by the government economic team, only BRL\$24 billion (22%) requires Congress' approval. The remaining BRL\$87 billion (78%) can be implemented solely by the Executive Branch.

President Rousseff may not be in a mood to deal with the two legislative leaders. Given their political, and potentially, legal problems, the prospect of her own impeachment related to the Petrobras scandal may be less of a threat as attention is focused more on the congressional leadership. Of course, problems in Congress do not help Rousseff or Levy, and her bigger political problem may still be the deepening recession and fiscal austerity that is being resisted by many Brazilians, as seen in the rise in protests, strikes, and even crime.

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