POLICY MONITOR

September 3 – 7, 2012

THE WEEK IN REVIEW

On the eve of the Brazilian national Holiday, September 7th, President Dilma Rousseff addressed the nation to announce a **reduction in energy bills to benefit both households and the industry**. "After raising 40 million Brazilians out of poverty and becoming the sixth largest economy in the world, [Brazil] prepares to take a new leap – and to grow stronger and better." To be detailed next week as a part of the renewal of private concessions for the hydropower energy sector, the reduction should amount on average to 16.2% for households and up to 28% for industry. Rousseff also vowed to preserve the current job creation and tax cut policies without compromising the fiscal balance. MDIC (Ministry of Development, Industry and Foreign Trade) also issued a list of 100 products that will have their import tax increased – a protectionist step to curb imports. The administration has signaled it is preparing another list of import tax hikes for 100 additional products in October (see below). And after a series of domestic tax cuts for sectors such as auto and construction, and given budgetary restrictions, the administration will probably not promote any new tax relief until 2013. Meanwhile, IBGE (statistics agency) reported a **trade surplus of US$ 2.87 billion in August, a 17% slump over August 2011 mostly caused by the drop in the international prices of iron ore**. Interestingly, according to estimates by AEB (Association of Foreign Trade) soy-based products should replace iron ore as the main Brazilian export in 2013.

On the political front, a new round of electoral polls presents a dire situation for PT (Labor Party) candidates in the upcoming October mayoral elections (see The Pulse). Among the 26 capitals observed, only in Goiânia (Goiás state) is the PT candidate a clear front-runner. Given that PT candidates are struggling in important cities such as São Paulo and Belo Horizonte, **both former President Lula da Silva and President Rousseff have decided to campaign more actively in their favor in the incoming weeks, a strategy designed not only to secure a victory in the mayoral race but also to pave the way for Rousseff´s reelection bid in 2014.**

Below, key policies that were tracked by PATRI during the week.

Trade Facilitation

Import Tariff Increase

Overview

In an effort to protect domestic industry from foreign competitors, CAMEX (Foreign Trade Council) temporarily increased the import tariff on 100 products. The list of products includes certain types of steel, petrochemicals, tires, building material, pharmaceutical goods, potatoes and others. Tariffs on these items were raised from as low as zero to an average of 25%.

Mercosur member countries approved the creation of this list of products in order to protect domestic producers from import competition at a time of sluggish economic growth. The announced tax hike will not be automatic, since it still has to be approved by all Mercosur member countries. They have 15 days to decide on this matter.

Next Step

CAMEX is going to publish a second list with 100 additional products, probably in October. This week's list of products is temporary and is valid for 12 months and can be extended for an additional 12 months.

Tax & Investment

Land Acquisition by Foreigners

Overview

Bill PL 2289/07, which regulates the acquisition and leasing of rural areas by foreigners, was approved by CAPADR (House Committee on Agriculture, Livestock, Supply and Rural Development). The bill approved contains a substitute that adapts the original bill which originated in the report of the SUBESTRA (Subcommittee on Land Acquisition by Foreigners), PL 4059/12.

Some of the differences between PL 4059/12 and the Substitute presented are:

- Rural properties acquired by Brazilian legal entities, regardless of whether they are incorporated or controlled directly or indirectly by foreign private individuals or companies, **should be associated with an agro-industrial project that adds value and generates income and employment for the region**
- The National Defense Council will not be responsible for determining the areas essential to national security
- Removes the amendments to Law 5868/72 establishing the National Rural Registration System, which determined that registrations should be digitalized and published, creating a database
- Removes the amendments to Law 9393/96 (Rural Property Tax Act), which determined that the taxpayer had to communicate to SRF (Internal Revenue Service) the nationality of the person associated with the land and changes in the following cases:
    - Surface ownership
    - Forest concession
    - Temporary transfer of land use, for any purpose, including rental or rural partnership

Next Steps

The bill has to be approved by CFT (Committee on Finance and Taxation) and CCJC (Committee on Constitution and Justice).

Bidding Process

Overview

PL 4384/12, which includes integrated contracting as part of the bidding process, was introduced as a way to simplify certain procedures. The bill amends Law 8666/93, which provides regulations for procurement processes. This new bill includes integrated contracting as the development of basic and executive projects, execution of works and engineering services, assembly, testing, pre-operation and all other operations necessary and sufficient for final delivery.

Next Steps

The bill is awaiting dispatch to a standing committee and may be referred to the CFT (House Committees on Finance and Taxation) and CCJC (House Constitution, Justice and Citizenship).

2013 Budget Proposal

Overview

Last Friday (August 31), the Rousseff Administration sent the 2013 Draft Budget Law to Congress. It estimates a total revenue and expense of BRL$ 2.25 trillion (US$ 1.13 trillion) for

2013. In the budget, BRL$ 52.25 billion (US$ 26.13 billion) will de designated for PAC (Growth Acceleration Program) Infrastructure and the *Minha Casa, Minha Vida* low-income housing program; BRL$ 79.33 billion (US$ 39.67 billion) for health; BRL$ 38.1 billion (US$ 19.1 billion) for education; and BRL$ 29.93 billion (US$ 14.97 billion) for the *Brasil sem Miséria* program that aims to eradicate extreme poverty by 2014.

Altogether, the budget foresees investments of BRL$ 187 billion (US$ 93.5 billion), of which BRL$ 110.6 billion (US$ 55.3 billion) will come from state-owned companies. Moreover, the government also expects BRL$ 15.2 billion (US$ 7.6 billion) spent on tax relief, which should be announced in the coming months. The government has not said which sectors will benefit, but said the measures will focus on stimulating the economy (payroll tax relief and reduction of energy costs, for example).

The government used the following parameters to calculate revenue:

- GDP: 4.5%
- Inflation: 4.5%
- Average Exchange Rate: US$ 2.03 / dollar
- Average Interest Rate: 8.03% per year
- Minimum Wage: BRL$ 670.95 per month (US$ 335.48)

Considering these indicators, the government hopes to achieve a primary surplus of BRL$ 155.9 billion (US$ 78 billion) or 3.1% of GDP. Thus, it is expected that in 2013 the net public debt will maintain its downward trend and reach 32.7% of GDP.

Next Step
Congress has until December 22, 2012 to vote on the 2013 budget proposal.

Energy & Environment

Ethanol Regulation

Overview

Ethanol production activity in Brazil will begin to be regulated by ANP (National Petroleum Agency). The agency will regulate activities covering the construction, capacity expansion, modification and operation of ethanol production plants. Some of the highlights of the new regulation are:

- Increased bureaucracy. For example, prior authorization, which is granted in two parts for construction and operation, will be required.
- Guarantee of fuel supply becomes an obligation of producers
- Projects that are already in operation will need to be ratified

With the publication of MP 532/2011, converted into Law 12.490/2011, the responsibility for defining strategies and developing economic and technology policies for the Brazilian biofuels industry was transferred to ANP. As part of the process, an internal working group was created to evaluate the impacts of this new regulation and propose actions for compliance.

Forest Code

Overview

A vote on Provisional Measure (MP) 571/12, which amends the New Forest Code (Law 12.651/12), was postponed due to lack of agreement between congressmen. The Provisional Measure will probably be on the schedule of the House Plenary on September 18.

Next Steps

The measure has to be voted on by the House. The MP expires on October 9, 2012.

Extra

World Economic Forum

Overview

The WEF (World Economic Forum) released this week the [2012-2013 Global Competitiveness Report](), where they rank the competitiveness of 144 countries. This year Brazil got bumped up into the top 50, a position never obtained by the country in the past. Brazil climbed up 5 positions, ranking 48 amongst criteria such as availability of capital, flexibility of labor markets, economic stability, infrastructure and public services.

According to the WEF, "Overall, Brazil's fairly sophisticated business community (33rd) enjoys the benefits of one of the world's largest internal markets (7th), which allows for important economies of scale and continues to have fairly easy access to financing (40th) for its investment projects." However, the report also pinpoints challenges such as trust in politicians (121st), government efficiency (111th), excessive government regulation (144th) and wasteful spending (135th).

THE PULSE

2012 BRAZILIAN MUNICIPAL ELECTIONS – SÃO PAULO

As Brazil's largest and most influential city and business hub, its mayoral race is vital. Winning in São Paulo could place the victorious party in an advantageous position in the federal level, and the results are likely to have implications for the PT and the next presidential election. A new political figure—Celso Russomano from PRB (Brazilian Republican Party), a former reporter who has made his political career as a consumer rights advocate—has unexpectedly taken the lead. He has overcome the favorite candidate in the polls, José Serra, former mayor, governor and presidential candidate of PSDB (Brazilian Social Democracy Party) and, as the Ibope poll indicates, Russomano is at 31% among likely voters. Serra is now technically tied with the PT (Labor Party) candidate and former Education Minister, Fernando Haddad, a political novice picked by former President Lula. Support from Lula and, indirectly, from President Rousseff has been proving essential for Haddad's hike in numbers. The duo has been working intensively to boost election results in favor of their party.

The rest of the country will also be voting in October. About 138.5 million voters will elect mayors and city councilman in 5,568 municipalities. The majority of these cities (92.3%) concentrate groups of up to 50,000 voters. These elections are highlighted by an increase of about 10% in city councilmen seats due to a constitutional amendment that establishes the limit of seats depending on the number of inhabitants. Cities can hold up to 55 seats. According to the National Confederation of Municipalities, the State of Rio de Janeiro, for example, increased the number of seats by 34.5%.

Today, Brazil has 30 political parties. Rousseff's party, the PT, currently holds 7 state capitals. However, a recent PATRI survey reveals that in this election cycle PSDB could obtain 6 capitals, followed by PSB (4), PMDB (3) and PT with only 2. On August 21st, Brazil began an important phase of the elections with the beginning of free TV airtime for the candidates. All parties get free time on national TV, with the time split among the parties according to their representation in Congress. During this phase, strategic alliances and support from key political players can still change the results of this municipal election.