Brazil-U.S. Business Council

PATRI

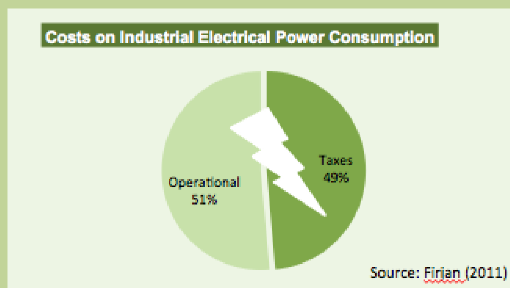
POLICY MONITOR

September 10 – 14, 2012

THE WEEK IN REVIEW

As anticipated, the main economic development of the week was the **Rousseff administration's announcement of a detailed plan to cut electricity costs** (see below)**.** To be carried out in 2013, cuts will drop household rates by 20.2% and industrial rates by between 19% and 28%. In PATRI´s view, the price reduction will not only generate much needed relief for industry, but will also put pressure on the 26 states to reduce the ICMS (VAT) tax on energy bills. The energy price reduction could also create some room for Petrobrás to increase gas prices in 2013 without further inflation pressures (see below). Three other government announcements made headlines: **Central Bank President Alexandre Tombini pointed out the slight inflation increase due to high commodity prices, but assured that it is temporary and that the country's economy remains on a path of gradual recovery**; Finance Minister Guido Mantega **reduced the GDP forecast from 3% to 2%** and **laid out the 25 additional sectors to receive an extension in payroll tax relief;** and, on the economic front, the Fed's bold announcement of a new U.S. open-ended mortgage bond-buying scheme should put pressure on the Brazilian currency.

On the political front, given that many Congressmen are candidates for the upcoming October mayoral race and are not focused on Legislative activities, both the speaker of the House, Marco Maia, and the President of the Senate, José Sarney, decided to jointly push for a vote on MP (Provisional Decree) 571, which amends the Forest Code before the October 8th deadline. However, other important bills, such as MPs 575 and 576, which create incentives for Public Private Partnerships (PPPs) in the infrastructure sector, will probably be voted on after the elections. As the campaign trail heats up, former president Fernando Henrique Cardoso, from PSDB (Social Democrat Party), traded barbs with Fernando Haddad, the PT (Labor Party) candidate for the city of São Paulo.



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

Energy & Environment

Electricity Cost Reductions

Overview

In an effort to lower production costs and promote faster economic growth, the Rousseff administration announced a package of measures to reduce the cost of electricity. These measures represent an average reduction of 20.2%, and consumers will begin to feel them by 2013. For industry, the drop in energy costs is between 19% and 28%. The measures include three main points:

- Renewal of electricity concessions that begin to expire in 2015
- Elimination and reduction of sector fees

- A price tag of BRL$ 3.3 billion (US$ 1.65 billion)

Renewal of Concessions
According to the law, concession contracts that have already had their periods extended once cannot have additional extensions, which would lead to an obligation to conduct further bids. However, the government decided to issue a Provisional Decree (MP) to amend the law to allow more than one concession renewal.

Concessionaires that decide to renew their contracts must follow these conditions:

- Renewal in advance for early 2013
- Renewal for a maximum period of 30 years
- Compensation calculated by ANEEL (Electricity Regulatory Agency)

Fees
The government has also decided to eliminate or reduce the collection of the following fees: CCC (Fuel Consumption Account), RGR (Global Reversion Reserve) and CDE (Energy Development Account).

In the case of CCC, even though the fee was eliminated, the remaining funds in the account will continue to be used to subsidize isolated systems. RGR will be eliminated for all utilities for new transmission projects and for concessions that were extended or auctioned. CDE will be reduced to 25%, and this fee will continue to be used for Social Electric Energy Tariff, *Luz para Todos*, National Coal and Alternative Energy Sources programs.

Government Contribution
Out of the 20.2% average reduction for consumers, 7% is related to annual inflow of BRL$ 3.3 billion (US$ 1.65 billion) from public coffers. The other 13.2% is related to other measures.

Petrobrás / Graça Foster

Overview
Graça Foster, president of Petrobrás, presented the company's business plan for 2012-2016 to the Senate's CI (Committee on Infrastructure) and CAE (Committee on Economic Affairs). Foster explained that social and economic development in the country was the main driver behind the increased consumption of petroleum derivatives (see below).

Petroleum Product Consumption: Brazil x World				
	Gasoline	**Diesel**	**Aviation Fuel**	**Fuel Oil**
Brazil	3.7%	3.3%	4%	-7.1%
World	1.3%	2.3%	-0.2%	-1.8%

Here are some of the highlights from her presentation:

- Regarding fuel price, volatility was not passed along to consumers, but Petrobrás seeks price parity in the medium and long term.
- The company has an installed capacity of 6.8 million cubic meters of biodiesel, which corresponds to a capacity 2.5 times larger than the current production.
- Between 2000 and 2011, there was a 73% increase in oil and gas production in the country due to the discoveries of new reserves.
- Petrobrás increased oil and natural gas production by 45%, while other foreign companies grew between 2% and 19%.
- A total of BRL$ 87.5 billion (US$ 43.75 billion dollars) were invested in 2012. Foster affirmed that the negative result in the second quarter was due to the company's debt in dollars, in addition to the drop in exports and lower production.
- Foster affirmed that there was no loss in yield potential, only a postponement in the production curve by two years.

For Foster's full presentation, click here:
Login: petrobras
Password: graça

CGEN (Genetic Material) Report

Overview

CGEN's (Genetic Material Managing Council) 2011 Report of Activities reveals the Council's low efficiency in approving applications for authorization of access to genetic resources and associated traditional knowledge. Some of the highlights include:

- CGEN issued, on average, 9.6 authorizations per year between 2002 and 2011
- In 2011, only 24 authorization processes were approved
- Compared to the average, the increase in approvals is still far below the number of new requests
- In 2011, 104 authorization requests were sent to CGEN
- New requests were added to a backlog of 200 applications
- 167 authorizations were granted through institutions accredited by CGEN. This value far exceeds the last three year averages of 47 authorizations. Approvals tend to occur more quickly in systems outside the Council.

Tax & Investment

Tax Relief Measures

Overview

The government announced the extension of payroll tax relief for 25 additional sectors. The sectors included will no longer pay the 20% INSS tax (employer contribution to social security) as of January 2013. The new rule provides for rates between 1% and 2% of revenues. This payroll tax relief began in August 2011 as part of the Greater Brazil Plan. The new sectors covered and government expectations include:

Sectors Covered:

- Poultry, pork and derivatives
- Fish
- Breads and pasta
- Drugs and medicines
- Medical and dental equipment
- Bicycles
- Optical instruments
- Pulp and paper
- Glass
- Stoves, refrigerators and washers
- Ceramics
- Stones and ornamental rocks
- Air transportation
- Paints and varnishes
- Metal Construction
- Railroad equipment
- Tool manufacturers
- Forged steel manufacturers
- Bolts, nuts and drawn wire
- Toys
- Tires and Tubes
- Computer and Technical Support
- Aircraft maintenance and repair
- Maritime, river and navigation support
- Road transportation

Government Expectations from the Sectors:

- Not fire workers
- Increase the number of employees with formal labor contracts (with *carteira assinada*)
- Increase investments
- Increase production and productivity
- Increase exports

Next Steps

1. A new MP will be published taking into account these new sectors that were included. Next, the decree will be sent to Congress, where the text can undergo modifications.
2. Some sectors that were announced today were already contemplated in MP 563, which will be sanctioned by President Rousseff by Monday, September 17.
3. Minister of Finance, Guido Mantega, also announced an accelerated depreciation of capital goods regime.

Trade Facilitation

New System: Trade Agreements

Overview

MDIC (Ministry of Development, Industry and Foreign Trade) launched a new system (CAPTA), which simplifies online queries about rates for preferential trade agreements signed by Brazil.

CAPTA is an online system that displays percentage reductions on import tariffs of signatory countries of a preferential trade agreement. Previously, this information was only obtained in the texts of agreements. In the future, CAPTA will also provide other data such as tax rates applied to products of the main competitors of Brazil.

Currently, Brazil is a signatory of the following trade preference agreements:

- Regional Tariff Preference between ALADI countries (PTR-04)
- Seed Agreement between ALADI countries (AG-02)
- Cultural Agreement between ALADI countries (AR-07)
- Brazil - Uruguay (ACE-02)
- Brazil - Argentina (ACE-14)
- Mercosur (ACE-18)
- Mercosur - Chile (ACE-35)
- Mercosur - Bolivia (ACE-36)
- Brazil - Mexico (ACE-53)
- Mercosur - Mexico (ACE-54)
- Automotive Mercosur - Mexico (ACE-55)
- Mercosur - Peru (ACE-58)
- Mercosur - Colombia, Ecuador and Venezuela (ACE-59)
- Brazil - Guyana (ACE-38)
- Brazil - Suriname (ACE-41)
- Mercosur - Cuba (ACE-62)
- Mercosur / India
- Mercosur / Israel

Extra

New Minister of Culture

Overview

Marta Suplicy, the former mayor of São Paulo (2001 – 2004), former Minister of Tourism (2007 – 2008) and current Senator from São Paulo for the PT party, took office as the new Minister of Culture. Suplicy replaces Ana de Hollanda, who was rumored to be leaving office on several occasions. The replacement was scheduled to happen after the 2012 mayoral elections, but Suplicy's participation in the São Paulo race and Hollanda's letter criticizing the Ministry of Culture's budget sped up the announcement. Suplicy was sworn in this Thursday (September 13). Below are some highlights from both Suplicy's and President Rousseff's speeches:

- Suplicy defended the approval of *Vale Cultura* (PL 5798/09), which awaits for a House vote
- Rousseff highlighted the Ministry's 2013 budget of nearly BRL$ 3 billion (US$ 1.5 billion), plus approximately BRL$ 2.2 billion (US$ 1.1 billion) from tax incentive laws. This total represents an increase of 65% compared to 2012

THE PULSE

"CUSTO BRASIL" – ENERGY COSTS

Boosting competitiveness is the Rousseff administration's motto. "Our main concern is to increase public and private investments, efficiency levels and our economy's competitiveness. This is crucial for us to continue to distribute income, increase employment and reduce poverty," highlighted President Rousseff during this week's announcement on electricity cost cuts. **Electricity – a heavy component of the so-called "Brazil Cost" – accounts for about 35% of production costs in the country.** "Brazil Cost" refers to the nation's main bottlenecks, such as high taxes, poor infrastructure and red tape. President Rousseff has a clear view of these deficiencies and is promoting what seem to be urgent structural changes to enhance the economy with fiscal, exchange and monetary measures combined with incentive tools and pro-investments conditions. Rousseff's plan to develop the domestic industry and foster Brazil's competitiveness is extensive and goes from lower interest rates to inflation control and local content requirements.

On a global scale, the sixth largest economy in the world occupies position 126 (out of 183) in the World Bank´s "Ease of Doing Business" rank, while the United States occupies the 4th place. This disparity is significant, and the "Brazil Cost" can explain a good part of it. Just taking energy costs as an example, a Firjan (Federation of Industries of the State of Rio de Janeiro) study points out that the **average industrial tariff in Brazil is BRL$ 329 (US$ 165) per unit of electricity consumed (MWh), while in the United States it is less than half, BRL$ 124.7 (US$ 62.4).** Electricity-tax cuts are important steps to reduce the "Brazil cost". In the case of energy, as previously mentioned, Rousseff strategically tied these cuts to investments by the companies seeking renewal of their concessions. This caused an initially negative reaction of the financial market due to possible "breaches in contract" with existing utilities. The changes that will be pursued by utilities companies should be observed closely in order to fully calculate the impact of the measures and if it will drive up growth and ensure the country's much-desired competitiveness boost.

Selected Rankings (2012)	BRAZIL	USA
Days required to start a business	119	6
Cost of Starting a Business (% of income per capita)	5.4	1.4
Cost of Getting Electricity (% of income per capita)	130.3	16.8
Time paying taxes (hours per year)	2,600	187
Total tax rate (% profit)	67.1	46.7

Source: Doing Business, World Bank (2012)