



INDUSTRY AND BRAZIL

A faint, light-colored outline map of Brazil is visible in the background, positioned to the right of the main title.

An agenda to grow more and better

EXECUTIVE SUMMARY

BRASÍLIA 2010

INDUSTRY AND BRAZIL

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AN AGENDA TO GROW MORE AND BETTER

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INTRODUCTION

Industry and Brazil – an agenda to grow more and better – presents the industry’s aspirations and its vision for Brazil over the next four years. It reaffirms a tradition, initiated back in 1998, of Industry establishing a dialogue with candidates for the Presidency of the Republic on an agenda for the Country.

The vision of industry is a result of a broad debate. Preparations for CNI’s contribution to the 2010 presidential elections began at the 4th National Meeting of Industry, which focused on priorities for 2011-2014. Over 1,500 entrepreneurs took part in defining the agenda for industry.

Doubling the *per capita* income every 15 years is the challenge proposed by industry to Brazil. This is not an impossible challenge. For it to be achieved, Brazil needs to tackle problems that reduce its potential to grow and build new competencies as required in an innovative, highly productive, and environmentally sustainable economy.

Industry should be at the center of the strategy. A strategy that combines more or less industry is not indifferent to the Country. Industry has a bearing on productivity and innovation in other economic activities and generates great influence on the Country’s activity level, jobs and exports.

Focusing on competitiveness is the path for the Country to have more industry. The priority of enterprises is to ensure competitive isonomy by reducing the so-called Brazil Cost. Industry generates greater added value and, for this reason, it is particularly affected by inefficiencies in our institutions and infrastructure. Having an action plan to eliminate the main obstacles hindering competitiveness in Brazil is the main challenge for the new federal administration.

New challenges must be urgently addressed. Lingering uncertainties in the international scenario and the emergence of new competitor countries reinforce the need for Brazil to implement an agenda that fundamentally depends on actions under our control. Addressing competitiveness problems is the best means to ensure the Country’s capacity to double its *per capita* income over the next 15 years.

Brazil cannot miss this opportunity. Industry is committed to making sure that this opportunity is not missed.

Armando Monteiro Neto
President of CNI



ARMANDO MONTEIRO NETO
President of CNI

**1 WHERE WE ARE,
WHERE WE ARE
HEADED TO**

Changes and challenges

Brazil changed a lot in the transition to the 21st century – and for the better. The next four years, between 2011 and 2014, will be a decisive period. Brazil can grow at rates in excess of 5% a year, provided that it respects lessons on the importance of stability, gives due priority to competitiveness, and makes further progress in modernizing economic and political institutions.

Growing makes all the difference

In the 1980s and 1990s, Brazil's *per capita* income grew by only 0.5% a year in average. At this pace, it would take 137 years for the Country to double its *per capita* income. Between 2004 and 2008, the average growth rate increased to 3.4% a year, a pace at which the income of Brazilians will double every 21 years.

The goal: doubling the *per capita* income every 15 years

Brazil can double its average individual income every 15 years. If the annual GDP increases by 5.5%, the country's *per capita* income will grow by 4.5%. At this pace, Brazil will increase its average income four-fold, rising to the level of the richest countries in the world by 2040 in terms of individual earnings.

The issue: How can the wealth of Brazilians be multiplied by four?

How can we, in a 30-year time span, take the leap from the current *per capita* income of US\$ 10,000 to an average income of US\$ 40,000 in Brazil?

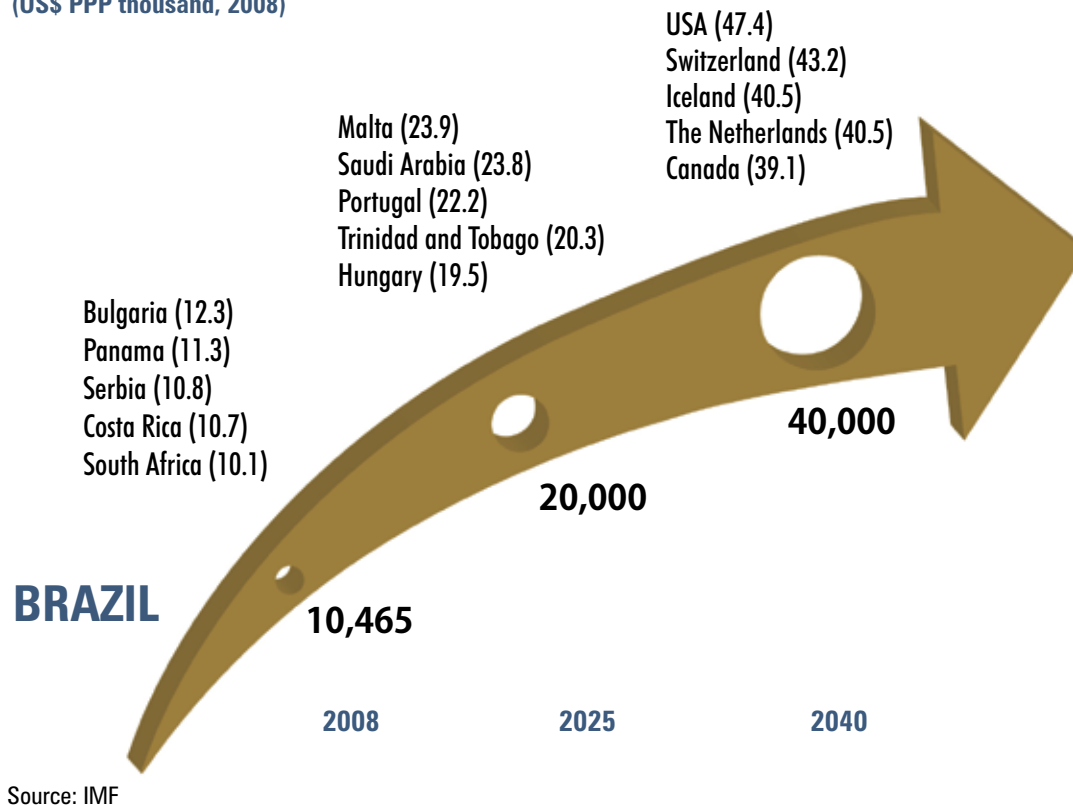
The answer: Sustaining the growth of the *per capita* income at 4.5% a year is the key.

This agenda details our vision of Brazil and of what should be done.

THE GROWTH CHALLENGE

Brazil with the same *per capita* income of the richest countries in the world, growing at 4.5% year for three decades

(US\$ PPP thousand, 2008)



1.1 INDUSTRY AT THE CENTER OF THE STRATEGY

Periods marked by more intense growth are led by the performance of Industry and by the investments it makes. Encouraging Brazilian industry to remain competitive and diversified and to continue to lead economic growth is the path for sustained growth.

The UN Industrial Development Report 2009 stresses that the manufacturing industry is the driving force behind countries that are growing at the most significant – and sustainable – rates.

Having more or less industry makes all the difference

There is no single model for countries to grow. However, notwithstanding the unique features of each country, there is a common element involved in ensuring successful growth, namely, the manufacturing industry base.

Industry plays a powerful role in fostering positive changes due to its impact on the economy's global productivity. Industry has a powerful bearing on other segments of the productive system because of its multiplier effect on growth.

A Country with an Industrial focus has better attributes to grow economically

The first and most important one is the strong association between manufacturing activity and technology, which dictates a pressing need for constantly updating the production cycle. This leads to the second attribute – the demand for training skilled labor, capable of absorbing technological advances and keeping abreast of them.

The path to a more intense growth entails production diversification and exports of manufactured products

Economies such as the Brazilian one, with a *per capita* income of less than US\$ 20,000, are – according to the UN Report – in a phase of the growth process marked by the need to diversify production and add new sectors and products to be sold in new markets.

The formula of success: more technology, more sophistication, more added value

Brazil needs to produce more sophisticated goods and solutions embedding more technology and knowledge. When the income increases, countries in growth processes tend to focus on producing goods of higher added value.

At such a stage, the manufacturing industry becomes more specialized. Production tends to migrate from less technological industries to enterprises provided with more state-of-the-art technological resources.

Brazil is faced with two challenges in terms of industrial policy:

- Reducing the Brazil Cost;
- Creating favorable conditions to promote changes in its industrial framework.

The kind of industry we want will define the Country we will have

Creating favorable conditions for changing the current industrial framework means preparing ourselves to build the industry of the future.

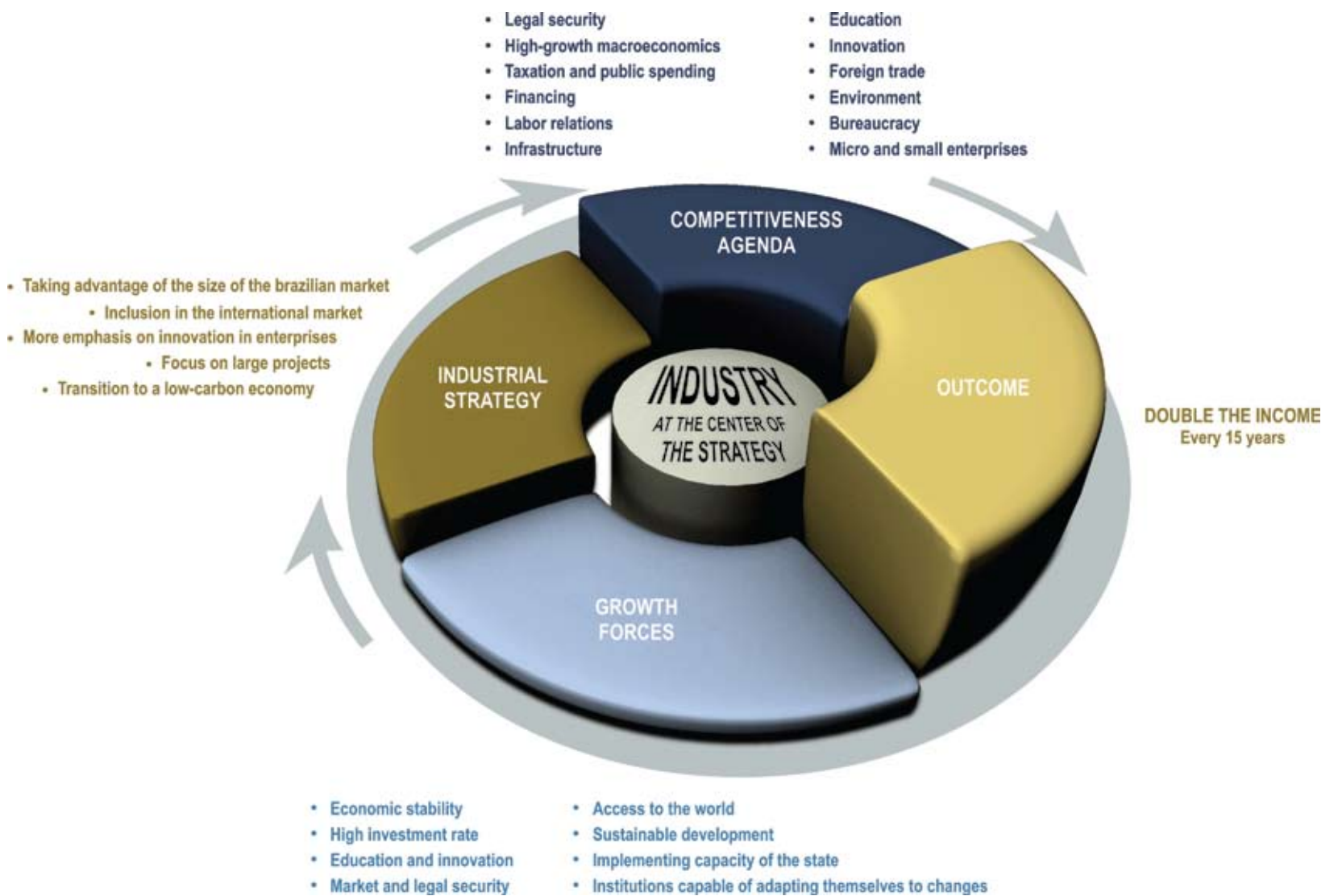
Part of this new industry will emerge from improvements in the economic environment brought about by the competitiveness agenda. Entrepreneurs respond quickly to new conditions in terms of venture capital, infrastructure, taxation, and red tape reduction.

But it is possible to go beyond that. It is necessary to focus on selective actions, by choosing the best path to follow, giving priority to sectors with comparative advantages, selecting key technologies and scientific segments to be developed, and training the necessary human resources for the new industry and new technologies.

1.2 THE FORCES OF SUSTAINED GROWTH

The advances, frustrations and setbacks experienced in Brazil's recent past provide a good script for what the Country should do to grow on a sustained and sustainable basis in coming years.

Growing more and better



Preserving macroeconomic stability

A high inflation corrodes the income of workers, creates uncertainties for investors, undermines the credit system, and jeopardizes long-term corporate planning.

The need to raise the investment rate

High investment rates are fundamental to ensure the sustainability of economic growth. Raising both public and private investment rates is the main challenge for Brazil to be able to grow on a sustained basis.

The importance of education and innovation

Education constitutes the foundation for productivity and innovation. These two elements are in the DNA of success cases of Brazilian enterprises that became more competitive in both the domestic and international markets.

The market and legal security

Competitive markets play a key role in ensuring economic changes and growth. These can not be built in a scenario of legal insecurity. Brazil's recent experience shows that when the rules of the game are uncertain, investments stop flowing or decrease.

Access to the world: markets and technology

The international economy is a major source of growth for the Country: access to markets, credit, venture capital, technologies and, increasingly, room for Brazilian enterprises to invest in.

The sustainable development equation

The environment is a source of both opportunities and risks. Reducing regulatory uncertainties will have a positive impact on the Country's capacity to face the challenges involved in the sustainability agenda. Natural resources and environmental quality can be preserved without inhibiting indispensable undertakings to ensure society's quality of life, jobs, consumption, and income.

Strategic and implementing capacity of the State

There is a recognized gap in the strategic and implementing capacity of the Brazilian State. The State functions better where planning capacity exists, where professionalism prevails, and where agencies of the administration are insulated from the influence of political parties and ideologies.

The need for adapting institutions continually

Economic, social, technological and demographic changes require constant adaptations in institutions. This process is more complex in Brazil owing to the constitutionalization of policies. The most fundamental changes for the Country invariably involve the Legislative Branch. Judicial and political institutions must also modernize themselves.

2 BRAZIL'S STRATEGY TO GROW

Ensuring sustained growth and structural changes in Industry

Brazil will only manage to sustain a solid growth rate if it can rely on an active industrial policy that can ensure a suitable environment for the competitive inclusion of enterprises in the global economy, taking full advantage of the potential of the Brazilian Industry to grow.

The Brazilian industrial strategy should focus on the following main areas:

a) Integration of the domestic market

The size of the domestic market is an asset that is being reinforced by a growing middle class and rising income in less developed regions of the country. More efficient infrastructure projects and a better taxation and spending system can make it easier to integrate new markets.

b) Internationalization

Actions in support of exports should be intensified not only to enhance demand, but also as a means to stimulate competitiveness gains.

c) Industrial innovation

Innovation must be at the core of industrial strategies, which requires not only earmarking more funds for Research and Development (R&D) but mainly investments in human capital. The National Innovation System should be strengthened while mechanisms to reduce risks associated with innovation are put in place.

d) Driving projects

Factors that induce manufacturing activity deserve special attention. New investment opportunities in the petroleum production chain emerged with the challenge of exploiting oil and gas in Brazil's pre-salt layer. Public policies in the housing sector stimulate the civil construction industry.

High-profile sporting events – such as the 2014 World Cup and the 2016 Olympic Games – generate unprecedented prospects due to the relevance and urgency of necessary civil construction projects in strategic sectors for Brazil and its largest capital cities, with positive repercussions on infrastructure, transportation, technology, tourism.

e) Low-carbon economy

Brazil should build a strategy focused on clean energy development and low-carbon manufacturing production and technologies.

Laying the foundations for the *Industry that we want and will build* will have repercussions for decades to come in our choice of the *Country that we will be and have*

3 THE COMPETITIVENESS AGENDA

3.1 A COMPARATIVE PICTURE OF BRAZIL IN THE WORLD

Brazil needs to move ahead faster. In a list of nine performance items, Brazil was ranked in the lowest one-third in six of them. This comparison was based on the economic behavior of 13 other countries – South Africa, Argentina, Australia, Canada, Chile, China, Colombia, Korea, Spain, India, Mexico, Poland and Russia.

CNI checked the competitive potential of Brazilian enterprises in the light of nine factors:

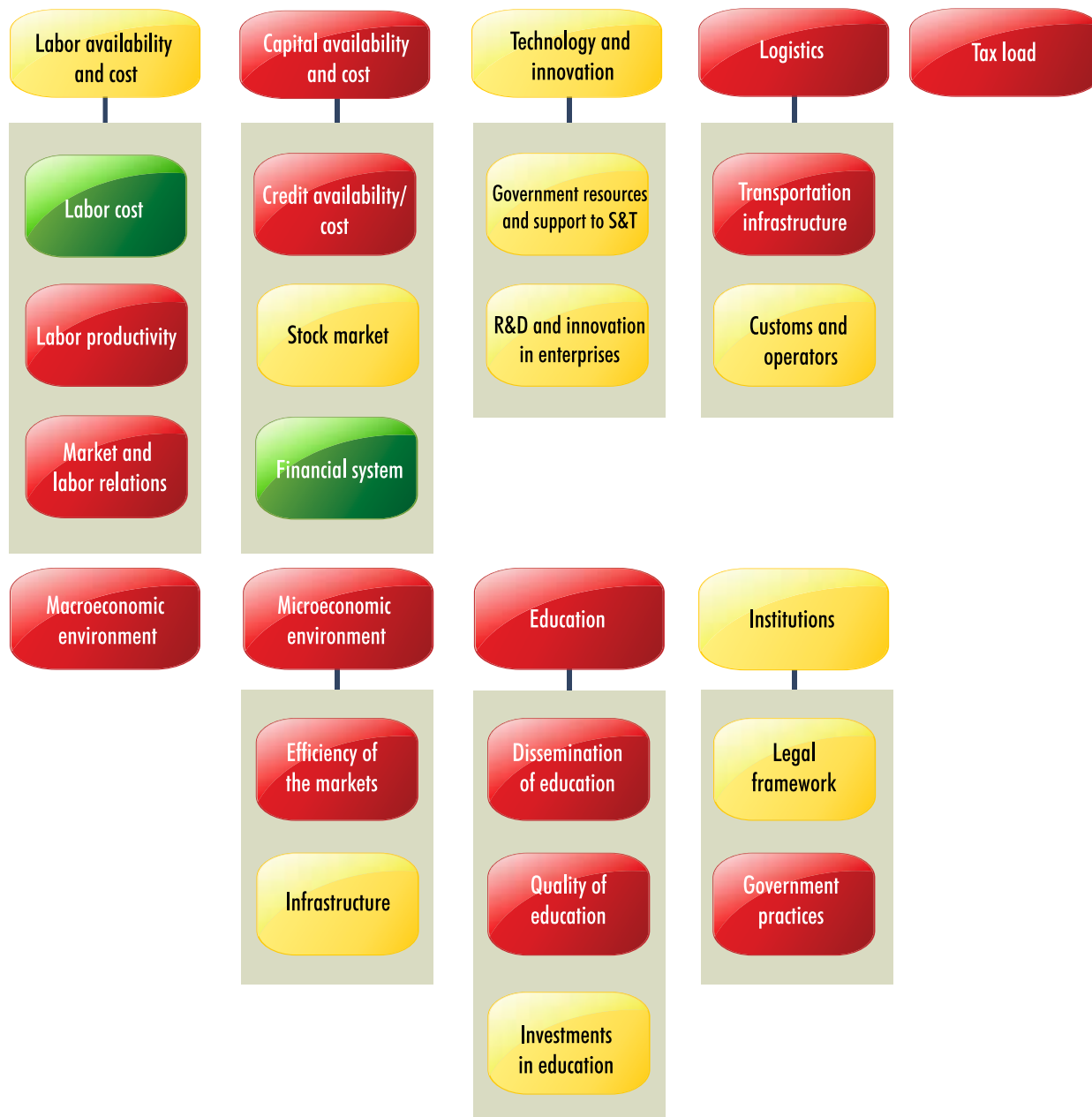
1. Labor availability and cost;
2. Capital availability and cost;
3. Technological level and innovative capacity;
4. Logistical framework;
5. Tax load;
6. Macro and microeconomic environment;
7. Economic infrastructure;
8. Schooling of the population;
9. Institutional environment of the country.

O The chart below shows Brazil's ranking in each of these factors and subfactors:

- the **green** color is used when the Country is ranked in the one-third of countries in a more favorable position (positions 1 to 4);
- the **yellow** color is used when it is ranked in the intermediary one-third (positions 5 to 10);
- the **red** color is used when it is ranked in the lowest one-third (positions 11 to 14).

COMPETITIVENESS

BRAZIL'S COMPARATIVE RANKING



Countries considered: South Africa, Argentina, Australia, Brazil, Canada, Chile, Colombia, South Korea, Spain, India, Mexico, Poland and Russia.

Captions: The colors of the boxes indicate Brazil's position in the ranking of the 14 countries. GREEN: Brazil is above the fifth position; YELLOW: Brazil is between the fifth and tenth positions; RED: Brazil is below of the tenth position.

Source: CNI

3.2 FACING COMPETITIVENESS CHALLENGES

The comparative study highlights the urgency of tackling issues associated with Brazilian economic competitiveness.

The intensity of the obstacles to be faced highlights the potential of the Brazilian economy to grow. They reveal how this growth is hindered and limited by the institutional environment.

Overcoming these barriers will release new driving forces and create favorable conditions for a sustainable growth cycle.

The CNI's Competitiveness Agenda contemplates 12 areas for action:

1. LEGAL SECURITY;
2. HIGH-GROWTH MACROECONOMICS;
3. TAXATION AND PUBLIC SPENDING;
4. FINANCING;
5. LABOR RELATIONS;
6. INFRASTRUCTURE;
7. EDUCATION;
8. INNOVATION;
9. FOREIGN TRADE;
10. ENVIRONMENT;
11. RED TAPE;
12. MICRO AND SMALL ENTERPRISES: A SPECIAL CASE.

3.2.1 Legal security

Industry and Brazil at large need to rely on clear rules to grow

Uncertainty – whether institutional, political, public, economic or legal – creates a negative and unproductive scenario that inhibits decision-making and scares off investments.

Legal security, a key principle of the Democratic Rule-of-Law State, can be summarized, from the perspective of entrepreneurs, in the following equation:

$$\begin{array}{c}
 \text{Stable past} \\
 + \\
 \text{predictability of the rules that will govern the future} \\
 + \\
 \text{effective enforceability of rights} \\
 = \\
 \text{DYNAMIC PRESENT}
 \end{array}$$

As the producer, enforcer and guarantor of the legal system, the State contributes most to a scenario of legal security or insecurity, particularly through the actions of the Executive, Legislative, and Judiciary branches.

MAIN PROPOSALS

- Political reform;
- Issuing of complementary rules to the Federal Constitution;
- Restrictions on the use of the so-called Provisional Measures;
- Respect for and guarantee of private property;
- Respect for the principle of separation of the branches;
- Deeper changes in the Judiciary Branch management;

3.2.2 High-growth macroeconomics

The key to growth: more investment

Macroeconomic management has a challenge to address: creating favorable conditions for increasing the investment rates of the economy.

The growth pace observed in the 2004-2008 cycle (4.8% a year, the average GDP rate) was consistent with an investment rate of 17% of GDP. An increase to 5.5% a year will require investment rates of about 22% of GDP.

A change in the economic strategy is required for Brazil to grow

Achieving growth targets requires changes in the relative weights of economic policy tools. The current macroeconomic equation has a bias that hinders the growth potential of the economy by penalizing the private sector.

The desirable quest for stability in Brazil is based on a strategy that amplifies the weight of the monetary policy, as it does not rely on the necessary contribution from the fiscal policy.

Three anchors of stability

Macroeconomic balance over the last decade was anchored in three solid pillars: fiscal balance (primary surplus), monetary policy (inflation target) and a flexible exchange rate. This combination, which was more characterized by pragmatism than by dogmatic postures, was successful.

Adjustments are a must

The recent past has taught us a lesson: reinventing macroeconomic policy is not necessary. However, promoting adjustments and improvements in it to ensure a balanced management of its three main components – the fiscal, monetary and exchange rate components – is a must. Interdependence among its tools should be respected and consistency among its targets should be aimed at, so as to preserve stability and foster an institutional environment that favors growth.

MAIN PROPOSALS

- Enhancing the saving capacity of the public sector;
- Implementing a Public Management Modernization Program;
- Encouraging families to save more;
- Preserving solid macroeconomic foundations.

3.2.3 Taxation and public spending

Taxation in Brazil is a factor hindering faster economic growth

The Brazilian tax system is efficient on the collecting side, but at the cost of dysfunctions that are not present in other tax systems. These problems are aggravated by a high tax load, which rose from 25.7% to 35.8% of GDP in the short span of 15 years, between 1993 and 2008.

The tax system should be reformed on the basis of new rules that can be used as tools for fostering economic growth. While a comprehensive tax reform is not actually carried out, specific corrections in the current tax rules are required to lessen their negative effects on economic growth.

The current tax system jeopardizes economic activity in many ways:

- It does not waive taxes on exported goods and services completely;
- It leads to tax incentives for imported products;
- It increases the cost of and discourages productive investments;
- It leads to the ineffective allocation of productive resources;
- It burdens enterprises and the public sector due to its high collection and control costs.

- It is difficult to harmonize it with the tax systems of other countries;
- It does not ensure legal security;
- It makes it difficult for the population to actually perceive the cost of taxes, reducing the participation of society in discussing how the public sector uses its tax revenue.

Public Spending: greater efficiency and better composition to boost economic growth

The continuous growth of current public spending in Brazil is an obstacle to high growth. Apart from increasing the tax load, this rising spending is mainly concentrated in current expenditures, to the detriment of investments.

It is therefore necessary to revise the fiscal dimension of public spending – including the social security system – through amendments to the Constitution, limits on increases in current spending, and measures to enhance public management efficiency.

The Brazilian tax system should be improved on two strategic fronts. From a long-term perspective, a comprehensive reform of the system is required while specific changes are implemented to tackle some of the main problems of the current system.

MAIN PROPOSALS

Taxation

- Unification of value-added taxes;
- Simplification of the tax framework;
- Full tax exemption for exports and investment;
- Guarantee of non-cumulative value-added taxation;
- Unification of income taxes (Income Tax and Social Contribution on Net Income (CSLL));
- Reduction in the number of taxes on the payroll.

Public Spending

- Setting fiscal goals for the Debt/GDP ratio and the nominal public deficit;
- Creating mechanisms to limit increases in current public spending so as to reduce the tax load and enhance the public sector's investing capacity;
- Reforming the General Social Security Regime;
- More effective budget management and a less rigid public budget;
- Implementing a Public Management Modernization Program.

3.2.4 Financing

High interest rates and difficulties to access credit are structural problems faced by Brazilian industry that reduce investments and jeopardize the daily operations of enterprises.

Credit hurdles limit Brazil's growth potential. The low volume of credit available prevents investments from growing and jeopardizes the cash flow of enterprises. Finding an effective solution to this problem is crucial for resuming economic growth on a sustained basis.

The Brazilian Industry agenda proposes measures to promote a macroeconomic scenario of reduced interest rates, with lower base rate, lower fiscal wedge on interest rates, less red tape, an expanded capital market, more non-bank credit, and greater legal and regulatory security.

MAIN PROPOSALS

- Promoting a macroeconomic scenario that leads to lower interest rates consistent with those applied in the global market;
- Developing policies under which reductions in the economy's base interest rate would also lead to reductions in the interest rates charged by banks;

- Facilitating access to credit on a more equal and fairer basis, rewarding good payers by approving a credit history recording system;
- Boosting the capital market and ensuring greater access to alternative non-bank credit to enterprises;
- Promoting legal and regulatory security for creditors, savers or shareholders.

3.2.5 Labor relations

The world of labor has changed in recent decades. It is modernizing itself and becoming more flexible in terms of how, when and where people can work. Temporary work (intermittent, casual, task-based, and on-line or distance work, based on tacit or standard agreements) is on the rise.

They fall under the category of work, not jobs. In Brazil, the world of labor has changed, but not the institutions. The Brazilian labor law is focused on jobs and does not consider work in a broader context appropriately. The current regulatory framework limits the space for free negotiations and refers all conflicts to the judicial sphere.

Rigidity and bureaucracy of the Brazilian labor law

The labor law is excessively rigid and complex. Too many laws give rise to conflicts, not solutions. Instead of regulating specific situations, the excessive number of laws and general administrative acts in Brazil leads to confusion and discrepancies, apart from inconsistency with other rules.

Legal insecurity

Legal insecurity in labor relations is also an obstacle to sustainable growth and much-needed structural changes in the Brazilian economy. It gives rise to hidden liabilities derived from changes in consolidated relationships and situations.

MAIN PROPOSALS

- **Social cohesion:** mechanisms should be created to expand collective bargaining possibilities, promote an effective tripartite dialogue, and ensure the enforcement of individual dispute settlement.
- **New forms of work:** outsourcing should be regulated, preserving the subsidiary responsibility of the service hirer and improving the law to allow for new labor contract modalities.
- **Legal insecurity:** the labor law should be modernized, a tripartite dialogue should be encouraged, a constitutional amendment should be passed to give powers to the High Labor Court (TST) to modulate the effects of its decisions, guidelines for the uniform application of the law by labor inspection agencies should be issued, procedural subrogation should be regulated, and labor inspection should be kept within the limits of the law.
- **Labor costs:** payroll-related hiring costs and other incremental costs which impose a burden on jobs should be reduced, and the differentiated treatment of micro and small enterprises should be expanded.

3.2.6 Infrastructure

Brazil invests little in infrastructure: total investment in infrastructure in Brazil – 2% of GDP – amounts to one-third of what is spent by China and Chile, and half of what India spends. The recovery of the Brazilian economy, the discovery of oil reserves in the pre-salt layer, and the holding of the 2014 World Cup and of the 2016 Olympic Games in Brazil afford unprecedented opportunities for the Country to advance and invest more in infrastructure.

A priority agenda to leverage infrastructure requires actions in the following areas:

- a) public management and red tape;
- b) regulatory agencies and participation of the private initiative;
- c) cargo transportation;

- d) energy;
- e) basic sanitation.

Licensing and tender procedures should take less time

Tender procedures for construction and other projects should be modernized based on sustainability and performance criteria, reinforcing the power of public procurement to foster changes. The speed of completion of construction projects is directly dependent on enhanced efficiency on the part of the public sector.

The private sector plays a key role in the area of infrastructure

Filling gaps in infrastructure depends on the effective participation of the private sector in investing in and managing services. For private capital to participate more in infrastructure, regulatory frameworks and management and sectoral planning frameworks must be improved.

Logistic costs are higher than those of competitors

Transportation costs in Brazil in major logistic stretches are much higher than average costs in the global market. This situation jeopardizes efforts to adjust the production sector to meet international competition and quality standards.

There is a clear need for an institutional reform involving all sectoral agencies to speed up the completion of projects, improve planning processes, enhance intermodality, improve resource management, and define more precise rules and guidelines for attracting private investments more intensely.

High energy cost and low competitiveness

The availability and costs of electricity play a key role in determining the industry's competitive capacity. In Brazil, energy rates for industrial consumers have increased above the inflation rate: between 2002 and 2007, the average rate grew by 21.6%. Electricity is expensive as compared to other competitor countries.

The weight and number of sectoral charges explain why electricity prices charged in the Country have increased so much. Apart from these charges, which have a weight of 12% in the electricity rate for industry, the tax load accounts for almost 40% of the total cost.

Basic sanitation

The slow expansion of basic sanitation systems and the low efficiency of services in this area have serious implications for the health of the population and for the environment. Low investment and institutional issues are at the root of the high deficit and gap in basic sanitation services.

MAIN PROPOSALS

- **Public management:** measures should be taken to improve planning and implementing capacity, reduce deadlines and red tape in tender procedures, and set clear rules for environmental licensing.
- **Regulatory agencies:** a Constitutional Amendment Bill addressing the role of these agencies should be passed, the general law on regulatory agencies should be improved, specific criteria should be taken into account in the process of selecting the directors of these agencies, the competencies of each regulatory agency should be clearly defined, and transparency should be ensured in decision-making and regulatory processes.
- **Cargo transportation:** transportation management and port administrations should be restructured by privatizing their management and remedying the financial situation of deficit enterprises, reducing the number of workers and labor disputes in public ports, increasing the supply of and competition in cabotage cargo transportation, reducing bottlenecks preventing faster railway transportation services, speeding up the expansion of airports and cargo terminals, granting authorization for private companies to operate in selected airports.
- **Energy:** charges on electricity bills and the deadlines for environmental licensing of projects should be reduced, areas in watersheds with hydric potential in the Amazon should be demarcated, concessions ending as of 2015 should be defined, new nuclear plants should be set up, the law on natural gas should be regulated;
- **Basic sanitation:** basic sanitation regulatory agencies should be structured, discussions at the Supreme Federal Court (STF) on who actually holds licenses should be finalized, efficiency in the management of sanitation companies should be enhanced, and wastefulness should be reduced.

3.2.7 Education

The quality of education is the key to economic growth

Economic growth depends on the supply of productive resources, particularly human capital. Brazil needs skilled labor to incorporate and develop new technologies.

Priority should be attached to basic education

Basic education is at the base of the process of developing human resources. To learn a profession and keep abreast of technological change, one must have developed appropriate skills in terms of reading, mathematics, interpretation, and logic reasoning.

Brazil has practically ensured universal access to primary education, but its higher enrollment rate was not accompanied by improvements in the quality of education. According to the National Basic Education Evaluation System (SAEB), little progress was made between 1995 and 2005. The Program for International Student Assessment (PISA) of 2006, organized by the OECD, ranks Brazil in the lowest positions.

Despite huge efforts to improve education in the past twenty years, current policies have not contributed to changing results. The fact that no public school network has achieved significant and stable scores in proficiency tests shows that Brazil has not adopted an appropriate education intervention and reform model so far. This scenario suggests that deep changes in the content and intensity of educational policies are required.

Students leave school unprepared for the labor market

From high school to university, the Brazilian educational system focuses mostly on academic aspects, disregarding the needs of a rapidly changing labor market and of the productive inclusion of young people and adults in it.

Brazil needs to invest in professional education, but without making the same mistakes as in the past. This is not to say that all secondary schools should be turned into professional training centers. But the supply of concomitant professional training courses and post-secondary education should be enhanced. Students should be able to choose the most appropriate path for their profile.

Higher education should be more flexible and diversified

Higher learning institutions in Brazil should be more in tune with the needs of the labor market and the regional environment. The compulsory focus of universities on education, research and extension courses should be reconsidered.

Higher learning institutions should be able to diversify their activities, offering courses according to their vocation and available resources and to the specific needs of the community and local labor market.

MAIN PROPOSALS

More resources should be earmarked for education, giving priority to basic education and quality aspects.

- Sponsoring permanent mobilization to improve the quality of education;
- Drawing up a State policy for education with the participation of society at large;
- Appropriate training for teachers and appreciation for them;
- Reviewing the design of secondary education;
- Achieving the goal of reducing illiteracy rates;
- Reducing the minimum age for enjoying the benefits of the Education of Young People and Adults program to 15 years;
- Encouraging partnerships between the public and private sectors to increase the supply of professional training courses;
- Stimulating professionalizing secondary education schemes;
- Replacing the gratuitousness of public universities with scholarships;
- Stimulating interaction between universities and enterprises;
- Adjusting the programmatic contents of higher education to the requirements of the knowledge society.

3.2.8 Innovation

A key element of the Brazilian industrial strategy

Innovation is the main engine for increasing productivity and the key element of the industrial policy agenda of more developed countries.

It is also a key element of the Brazilian industrial strategy. Brazil needs to make an even greater effort to promote innovation, particularly due to the features of its industrial framework, to the costs of production factors, and to the challenges of global competitiveness.

Innovation is not only an exercise of will

It is an economic decision that entails risks to win markets. It depends on the macroeconomic scenario – growth pace, cost and availability of capital, exchange rate, interest rates and taxation – and on the availability of various assets: skilled labor, solid research institutions, good suppliers, technical and technological services.

The Brazilian challenge is to increase the number of innovative enterprises and place innovation at the center of the industrial strategy. Innovation must become a day-to-day topic for the majority of enterprises.

There is a need for significantly enhancing the structure for supporting companies wishing to innovate through public and private partners that can provide required services and advisory, improve innovation management in enterprises, and assist them in defining innovation strategies and plans and in implementing and measuring their results.

The scope of supporting public policies must be expanded

There are three classic tools that governments can use to support innovation: tax incentives, subventions, and governmental orders. In Brazil, the scope of these three tools is still very limited. Tax incentives are the most widely used ones, but they are only available to companies that use the real profit tax regime and are not accessible to most companies, particularly to small and medium enterprises.

MAIN PROPOSALS

- Expanding and scaling up the innovation agenda;
- Reviewing and renewing the incentive base for innovation and the private-sector R&D spending;
- Increasing R&D subventions to the private sector by 50%;
- Removing obstacles in the application of mechanisms in support of the private sector;
- Giving priority to innovation in public procurement policies;
- Expanding the support provided to the Brazilian network of technical and technological services;
- Defining a comprehensive innovation agenda that goes beyond government support to private activities;
- Adopting standards and rules in controlled sectors, preventing regulation from becoming a hurdle;
- Encouraging the development of the financial subsystem in support of innovation;
- Changing the way companies are supported through subvention tools;
- Allowing beneficiaries of incentives to use tax credits beyond the fiscal year.

3.2.9 Foreign trade

Greater participation of Brazil in international trade requires global-quality institutions and regulations

Brazil is still not taking full advantage of trade opportunities available in the world. It is the 8th largest economy in the world, but it ranks 20th among the main exporting countries. When one considers only manufactured products, it drops to the 28th position in the world ranking.

Brazil can increase its participation in the international trade of manufactured products and take part in links of greater added value of global production chains. For this purpose, it needs to build institutions and regulations of global quality.

The main challenges facing Brazilian trade are:

- Sustaining the solid growth of exports registered in recent years;
- Ensuring diversification and growth of industrial exports;
- Facilitating the internationalization of Brazilian enterprises via foreign investment.

The priorities are the following ones:

Domestically: initiatives designed to reduce systemic costs, which affect exporting processes and undermine the international competitiveness of Brazilian enterprises.

Abroad: governmental policies for promoting exports and negotiations of trade agreements that can ensure tariff preferences to Brazilian enterprises, apart from stable conditions for accessing markets in other countries and operating in them.

Brazil needs to set up a new institutional framework for foreign trade and trade negotiations. The current situation is marked by:

- Poor coordination among government agencies in implementing specific policies and tools;
- Little convergence between the agenda of trade negotiations and corporate priorities.

MAIN PROPOSALS

- **A new institutional framework for foreign trade operations:** Relocating the Foreign Trade Chamber to the Office of the President of the Republic, setting in motion a broad reform in the Brazilian customs system, institutionalizing the dialogue between the Executive Branch and the corporate sector, adopting regulations in the National Congress for protocols of adhesion to Mercosur and trade agreements signed by the Brazilian Executive Branch.

- **Export financing:** Coordinating the actions of BNDES-EXIM and Banco do Brasil in financing exports and setting up a working group with representatives of CONEX and Government to discuss and assess the project for establishing the Eximbank.
- **Customs simplification and debureaucratization:** Simplifying customs procedures, rationalizing rules and regulations, ensuring the non-stop operation of customs, unifying business hours of agencies and organizations, enhancing the use of electronic documents, encouraging single controls, speeding up the implementation of digital certificates of origin, enhancing the efficiency of ports and airports, simplifying special customs regimes.
- **Trade promotion:** Coordinating the trade promotion policy, developing specific programs, implementing programs to strengthen the Brazil brand in potentially relevant countries.
- **Fighting protectionism:** New trade barriers which affect Brazilian exports should continue to be monitored, compliance with trade rules agreed upon by partners at the WTO or in bilateral or regional agreements with Brazil should be ensured, dispute settlement forums available in agreements to eliminate new barriers and avoid protectionist measures should be bilaterally negotiated and actually used.
- **Market access:** Supporting the completion of the WTO Doha Round, adopting a negotiation agenda which gives priority to market access, finalizing comprehensive free-trade agreements with Mexico and countries of the Persian Gulf, deepening trade agreements with India and South Africa, completing changes in the network of bilateral agreements within ALADI, and finalizing negotiations with the European Union.
- **Mercosur:** Implementing efforts in the Mercosur free trade area, defending the interests of Brazilian enterprises, using diplomatic means or relying on institutional mechanisms. Influencing the economic policies of other countries of the bloc, seeking to ensure greater predictability and legal security for Brazilian investments in the region. Negotiating permission for partners to advance at different speeds in foreign negotiations of the bloc.
- **Trade and climate:** Incorporating mechanisms to prevent the adoption of trade barriers in domestic laws in climate change agreements.

- **Internationalization of enterprises:** Revising and improving tax laws and practices applicable to taxes on international operations of Brazilian enterprises. Increasing the predictability and effectiveness of agreements to avoid double taxation of commitments signed by Brazil.

3.2.10 Environment

Industry is a pillar of sustainability

Industry is a positive force in building the sustainability agenda. It can play an even greater role in this regard if the concepts applied to policy models are changed and legal uncertainties that prevail in environmental regulations are reduced.

A necessary change: adopting the action philosophy

The first change to be made in the relationship between industry and environment is adopting the action philosophy. Too much priority is placed on imposing costs and regulations, lessening the focus on the desired and necessary partnership between government and industry for consolidating sustainable development.

Another need: Greater security in rules

The second challenge to be faced is that of reducing legal insecurity. The overlapping of competencies, excessive judicialization and lack of objectivity in environmental rules lead to significant transaction costs for enterprises and delay investments.

MAIN PROPOSALS

- Establishing clear rules for the competency of the federated entities in environmental licensing;
- Approval of a National Solid Waste Policy;
- Revision of the Forest Code;

- Revision of the National Water Resources Plan;
- Stimulating private sector participation in drawing up public policies on paying for environmental services (PSA).

3.2.11 Red tape

Excessive bureaucracy undermines Brazil's competitiveness and growth potential

Red tape increases production time and costs and diverts resources to unproductive activities, apart from stimulating corruption. Because of the long time it takes to process documents and carry out inspections provided for in the law, Brazilian enterprises need more time than their competitors in other countries to produce and deliver goods to consumers, making it difficult for them to integrate into value chains and to grow.

In addition to increased costs derived from excessive rules, complexity and frequent changes lead to mistakes in complying with legal obligations, resulting in additional costs with penalties, judicial appeals, and corrections in statements.

Bureaucracy also undermines the efficiency of the State. Inspection and control are prioritized over efficiency and serving society. As a result, more inspectors are required and the cost for processing and storing necessary information increases. The State becomes slow, expensive and ineffective.

Governments mistrust citizens

For red tape to be reduced, changes in the culture of the State and of the public service are required. One of the reasons why Brazil has so many regulations and controls is that mistrust prevails in the relationship between government and society.

Brazil has many examples of initiatives to simplify procedures for setting up enterprises. These initiatives should be extended to all other areas affected by excessive red tape. In this regard, priority should be given to the labor law, bookkeeping obligations, environmental laws, and tax collection procedures.

The policy for reducing red tape should be actively supported by the Office of the President of the Republic. But a red tape reduction program needs to rely on society's participation and should not be restricted to government.

MAIN PROPOSALS

- Reducing, simplifying and unifying procedures for setting up a business operation;
- Compliance with the provisions of Complementary Law n. 95 of February 26, 1998, that is, rules should be clear and objective;
- The mistrust prevailing between the State and citizens should be abolished and the focus of their relationship should be switched to the rights of citizens and enterprises, efficiency, and economic growth;
- A permanent program against excessive red tape should be created;
- The Office of the President of the Republic should actively support the program for reducing excessive red tape. The variety of agencies involved requires a top-down approach;
- A mechanism for the State to work jointly with society for this purpose should be established.

3.2.12 Micro and small enterprises: a special case

MSEs are key players in the Brazilian economy

Micro and small enterprises (MSEs) play a key role in fostering Brazil's economic development. There are many of them in the Country and they boost competition and the free market. They create jobs and, because they are small, they are more flexible and more capable of responding to innovation. Entrepreneurship implies occupation, income and citizenship for entrepreneurs and workers alike. In small communities, MSEs are the pillars of the local economy.

Small enterprises need to rely on policies that support their operations

This segment faces many challenges in its operations, such as difficulties to access credit and information, little managerial training, and hurdles to build the capacity of staff. MSEs are highly vulnerable to the economic environment and cannot, by themselves, take care of all the necessary changes to foster their development.

“Think Small First”

Policies and regulations in Brazil must be built based on the “Think Small First” principle. It is a principle clearly set out in the Brazilian Federal Constitution, but one that is still far from being applied at all levels of government.

The MSE Act that was passed in 2006 heralded a new era in defense of small businesses. Both the innovations brought about by that law and the mobilization of entrepreneurs that resulted in its passage deserve special mention, as well as the comprehensive debate in society and in Congress that it generated.

However, much remains to be done still. Some parts of the Act have not been implemented yet and important measures still need to be built. Among other measures to be taken, simplifying the labor law is the natural path for building an institutional environment that favors entrepreneurship.

MAIN PROPOSALS

- Adoption of the “Think Small First” principle by all agencies and organizations at all levels of government;
- Expanding the policy in support of local productive arrangements;
- Reassessing the categorization of micro and small enterprises;
- Stepping up efforts to simplify and unify procedures to set up, close down, change and legalize enterprises;
- Simplifying requirements for accessing public credit;
- Encouraging the establishment of credit and credit guarantee cooperatives;
- Using public procurement more intensely as a policy in support of MSEs;
- Preparing a simplified taxation regime for labor.

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