



THE INKERMAN GROUP

Executive Summary

- Brazil is currently in its ascendancy, as result of its vast natural resources, sensible economic policies which have attracted foreign investment, and a President who has attracted the respect of the world.
- However, whilst Brazil shows a great deal of potential, there are a number of issues, namely a lack of infrastructure, high crime rates, a small domestic skills base and excessive bureaucracy, all of which could potentially retard the country's future growth, and which are of concern to any organisation wishing to operate in the Latin American giant.
- Brazil, with its new found wealth and influence, is likely to set its own agenda in international relations, picking and choosing its partners on various issues, rather than associating itself with one country's objectives in particular.
- Brazil's challenges are by no means insurmountable, although much will depend upon who succeeds popular President Lula in the October 2010 elections.

Brazil, arguably more than any other country in the world right now, is in its ascendancy. In October 2009 alone it was awarded the right to host the 2016 Olympic Games, ahead of Madrid, Chicago and Tokyo, whilst also achieving a place on the UN Security Council for the next two years. The recent discoveries of light sweet crude, the holy grail of oil, off the country's vast coastline are estimated between 60 – 100 billion barrels, promising great wealth, and this for a country which is already in possession of vast natural resources which leave it entirely independent for its energy needs whilst also being in possession of 25% of the world's fresh water and 25% of its agricultural land. Although there were concerns that the former union leader Luiz Inacio Lula da Silva would lead the country towards the populist socialism which characterises the presidencies of Hugo Chávez in Venezuela, Evo Morales in Bolivia and Rafael Correa in Ecuador, he has instead implemented (or, at the very least, continued) rational centrist policies, which have aided the country's economic boom and also sought to tackle the inequality which is prevalent in much of Latin America. But whilst the country is undoubtedly a highly attractive prospect, there are a number of issues which threaten to retard the current progress. The Inkerman Monitor will examine the dramatic rise of the country, and its leader, and discuss the implications of this for the new world order, whilst also attempting to address a number of the challenges the country must still face and the implications of the 2010 presidential elections, which will see the much beloved Lula, who enjoys staggeringly high approval ratings of 81%, leave office.

Silva Lining

Brazil is a blessed country. Fertile land, plentiful fresh water supplies, vast territory and, with it, a plentiful supply of highly lucrative commodities. The country is free from ethnic conflicts or embroiled in border disputes. Of course such a country should be a prime target for Foreign Direct Investment (FDI). Of course foreign governments should be courting their President's support. Of course the voice of Brazilians, all 192,000,000 of them, should play a significant role on the international stage. But with all of these 'of courses', there remains an obvious question: why has it taken until now? And have the issues which made the country such a problematic partner in the past truly disappeared?

It appears that in the excitement surrounding the current progress being made in Brazil, some of the fundamental problems which have retarded the country's development in the past, and which still present a sizeable challenge to growth, have been largely ignored. This would explain, among other things, the surprise which followed the outbreak of violence in the favelas of Rio de Janeiro in October 2009, which, unfortunately for the Brazilian authorities, came just after the announcement that the city had been

successful in its bid for the 2016 Olympics. In order to look at these challenges, and to see whether they are in anyway surmountable, it is necessary to look at the origin of the present situation.

Brazil – A recent history

In order to put into context the current boom in Brazil, it is necessary to take at least a cursory look at the country's economic fortunes in the latter half of the 20th Century, fortunes which were mixed, to say the very least. In the late 1960's, as a result of reforms introduced by the country's military dictatorship following the coup of 1964, which included measures to increase investment, decrease balance of payments issues, devalue the currency and increase public investment to improve infrastructure, between 1968 and 1973, the country experienced an "economic miracle". In that period, the average annual rate of growth of gross domestic product (GDP) jumped to a staggering 11.1%. Whilst imports increased significantly during this period, the massive inflows of capital ensured the country operated a balance of payments surplus. Unfortunately however, this all stopped with the oil shock of 1973. This crisis proved the weakness of the government's state led development model, which was shown to be both inefficient and

unsustainable. Its collapse left the country in possession of a huge foreign debt and brought with it what has been perhaps the greatest scourge of Brazil's economy: inflation. The mid 1970s, through to the mid-1990s, were lost decades in Brazil, where growth went into reverse, infrastructure and education were neglected, the gap between rich and poor became almost insurmountable and crime rates surged.

The beginnings of the country's recovery came in 1994 when, in an effort to deal with inflation rates, which averaged an economy crippling 764% a year, Finance Minister Fernando Henrique Cardoso introduced a series of reforms, beginning with a new currency, the real, which achieved the unachievable of finally beginning to stabilise the highly erratic currency. As President, Cardoso instigated reforms such as a requirement that the country run a primary surplus. Crucially, these reforms brought confidence, not only among domestic consumers, but in the international community. Brazil became a country that companies and governments alike were comfortable doing business with, with disciplined markets bringing confidence of the feasibility of operating with, and within, the Latin American giant.

Which brings us to today. The combination of the fiscally responsible measures implemented by the government, alongside the boom in commodity prices in the first decade of the 21st Century, has meant that Brazil is ready to take its place at the 'grown-ups table', and the newly discovered oil reserves certainly haven't hurt. But it is not just their newly rediscovered economic success which has brought Brazil to this juncture (although, undeniably, this has been the primary factor). It is also a reflection of the tone struck by the much beloved Lula.

Brazil's place in the brave new world

Brazil is beginning to stretch its wings with regard to its new found international influence. What's more, the more it has used

this power, the more it has gained the gravitas to weigh in on other issues of international import. In its capacity as a regional power in Latin America, Brazil has led the UN mission in Haiti, which has been widely attributed with bringing some small semblance of stability to the long crisis ridden nation. Lula's emphasis upon the need to include developing nations in the global decision making process, moving the emphasis away from the G8 to the G20 has resonated across the globe, particularly in light of the economic crisis, and this has won him many supporters among leaders in the developing world. Brazil's intervention in 2008's tense diplomatic confrontation between Ecuador and Colombia, following the latter's deployment of troops into its neighbour's territory in an attempt to combat the threat of rebels from the Revolutionary Armed Forces of Colombia (FARC), was widely heralded as a success, with Brazil seen as a moderate and reasoned force within the region. Deals done with Paraguay over rights to the Itaipu dam, and Peru over hydroelectric power, all point to a country at the forefront of regional integration. Recognition of the country's growing influence and strategic importance is further reflected in the fact that it was rewarded a position on the UN Security Council.

From a western perspective, Lula represents a far more palatable Latin America. This in contrast to Venezuelan President Hugo Chávez's anti-American rhetoric, and the brand of populist socialism he (alongside Evo Morales of Bolivia, and Rafael Correa of Ecuador in particular) is seen to represent.

So is Brazil the perfect partner?

All of which may lead you to conclude that Brazil is the brand new shiny toy for the West to play with. Economic stability and growth. Vast commodity wealth. Internationally respected moderate leader. All the makings of a country in which companies wish to invest and governments wish to make partnerships.

However, Brazil, is not a perfect picture of an international partner, either in business or in politics. The reason to proceed with caution may broadly be split into two categories. Firstly, that there are a number of factors which are a cause for concern – crime, infrastructure and education to name but a few – which present a barrier to those wishing to operate within the country. Secondly, on a far more international level, that the government is clearly following an independent strategy in pursuit of the national interest which is reliant upon shrewd judgements of individual scenarios as opposed to hitching the Brazilian cart to one particular country, or group of countries, wagon.

Barriers to progress

There are a number of factors which Brazil must seek to overcome, or else face the prospect that its laudable growth rates will prove unsustainable, and government efforts to improve the lives of millions of Brazilians living in poverty will be for naught.

Infrastructure

If in October 2009 attention was turned to the threat that crime still poses to Brazil's hard fought for progress, in November 2009 it was the issue of infrastructure, or lack thereof, which came to the attention of the masses. On 10 November 2009, a huge power failure, which left 60 million people across the country in the dark, forced questions as to whether the country could guarantee electricity for a surging economy. After severe energy shortages and rationing in 2001, Brazil diversified its energy supply. However, an inherent vulnerability in the present system is the fact that because the nation's power grid has become more interconnected, a glitch in one part can affect a wider area.

The inadequacy of Brazil's infrastructure is widely cited as the country's biggest challenge for growth by politicians, economists and businesses. One of the legacies of the oil shocks of the 1970s, and the ensuing collapse

of economic growth was a total breakdown investment in infrastructure, which in a country as vast as Brazil is a barrier which cannot be ignored. Whilst attempts to modernise the country's crumbling infrastructure are going ahead, they are crippled by bureaucracy and a lethargic judiciary. In 2007, the government launched its Accelerated Growth Programme (PAC), in an effort to deliver R\$503.9bn in public and private spending on infrastructure, with more than half dedicated to energy projects. Of the total, R\$67.8bn was due to come from the federal government and R\$436.1bn from public and private sector companies. However, less than half of the planned spending had taken place by August 2009. Thus, billions of investment in ports, road construction and the energy sector exist only on paper, and the government has been widely criticised for its failure to get these projects "off the drawing board" so to speak.

Whilst the energy sector is seen as the most significant bottleneck in the way of sustained growth, one of the most recent examples of the cost of this lack of investment, and of its potential to severely hamper Brazil's growth aspirations, may be witnessed by examining the case of the country's burgeoning agriculture sector. As concerns over global food security continue to grow, many have looked eagerly to Brazil, one of the few big producer nations with room for growth. There are 72 million hectares (ha) under crops in Brazil and 172 million ha under pasture. Another 96 million ha of cultivatable land is available without touching environmentally sensitive areas. However, there are credible fears that output is reaching its limit and that the investment needed for growth, especially in transport infrastructure, is not being provided. Among the obstacles of red tape and high taxes, a lack of rail and water transport means almost all production travels up to 2,000 kilometres on poorly maintained roads to port at a cost of about US\$100 a tonne, compared with about US\$30 in the US.

Red Tape

As mentioned above, red tape, politely referred to as “excessive bureaucracy”, is seen to present a major barrier to operating within Brazil. According to the World Bank’s Doing Business 2010 report, a document which is aimed at providing an objective basis for understanding and improving the regulatory environment for business, Brazil sits a pitiful 129 out of 183, directly behind Micronesia. Within the region it is only ahead of Ecuador, Honduras, Haiti, Bolivia and Venezuela in the rankings, not particularly impressive for a country marketing itself as the logical place for foreign investment in the region.

DOING BUSINESS 2010	RANK (out of 183)
Ease of Doing Business	129
Starting a Business	126
Dealing with Construction Permits	113
Employing Workers	138
Registering Property	120
Getting Credit	87
Protecting Investors	73
Paying Taxes	150
Trading Across Borders	100
Enforcing Contracts	100
Closing a Business	131

Education

There is a notable skills gap in Brazil which poses an obstacle to both domestic and international organisations. Despite being one of the world’s most populous countries, Brazil does not have a single university ranked in the top 100 internationally. Of its college graduates, just 5% are engineers, far below the rates of countries such as China and South Korea.

Whilst education in Brazil has changed dramatically in recent years – access to basic education is nearly universal, secondary education has been expanding very rapidly, and so too has higher education at both the

undergraduate and graduate levels – education experts argue that serious issues remain related to quality, equity and inappropriate use of resources. A number of these are said to reflect the fact that Brazil started to develop its education institutions very late, and did not build strong teaching and academic professions that could provide the necessary support for education policies committed to equity, quality and efficiency. Resolution of such issues is a long term prospect. A survey of more than 1,700 industrial firms by Brazil’s National Confederation of Industry in 2008 found that more than half could not find enough trained workers. However, one solution being put forward by companies such as mining giant Vale is to do their own ‘in house’ training. For the last several years, aeroplane manufacturer Embraer has partnered with Brazilian universities to train thousands of engineers, and in June 2009, the company opened an educational headquarters at its Eugenio de Melo plant in Sao Paulo state.

Crime

Brazil is infamous for its crime rates. Although the situation has improved somewhat in recent years, with notable instances such as the fact that the murder rate in Sao Paulo has more than halved since 1999, when it hit a high of 35.7 per 100,000. However crime in Brazil, particularly in the cities’ notorious favelas, continues, and has presented the most visible area of concern. As an organisation, the prospect of harm coming to your staff, and the inability to guarantee, to a satisfactory standard, the security of your property, presents a significant obstacle. For those companies that consider the potential gains justify the risk, the cost of taking measures to mitigate the risk to both personnel and property will add a substantial cost to operations.

To those who only saw the Brazilian charm offensive engaged upon by members of both the country’s government and its military in recent months, alarm bells began to ring in October 2009 when the violent scenes of

buses being set on fire, fierce battles on the streets with gang members armed with grenades and automatic weapons, culminating in the shooting down of a police helicopter, were broadcast around the world, somewhat taking the shine off Brazil attaining the honour of hosting the 2016 Olympics. The clashes put into the spotlight the justifiable concern that Rio de Janeiro's notorious favelas and gun crime may pose a significant security threat to the Games. Brazilian officials were quick to respond in an effort to prevent the escalation of speculation about the city's suitability for the role of host, deploying 2,000 extra troops on the streets of Rio following the violent clashes between authorities and gang members, which left at least twenty-one people dead, including three police officers, whilst President Luiz Inácio Lula da Silva promised to allocate US\$60 million in aid to the city. Violence, particularly in the favelas, is by no means an unusual phenomenon, however the selection of Rio as the 2016 Olympic host has added urgency to efforts to quell what is widely considered to be one of the world's most dangerous major cities.

How well placed is Brazil to tackle its demons?

As we have seen, Brazil, for all its promise, is not without its problems. Infrastructure requires significant investment, as do efforts to increase the skills base of the population. Economic growth and the ensuing economic opportunities, coupled with a continuation of sensible, sustainable policies aimed at the redistribution, alongside a more reliable and engaged police force are necessary to address the issues of crime. Reforms are required to radically strip down the bureaucratic behemoth which can potentially strangle a new business, either domestic or foreign. These challenges are undoubtedly great. However, Brazil is currently being swept on a wave of forward momentum, inspired by sensible economic policies, the international respect for Lula who has instigated a pragmatic foreign policy and the anticipated revenue from the massive oil reserves found

off the coast. The combination of optimism and crucially money could well be a winning recipe, and it could reasonably be argued that if any country could overcome its problems, few are as well placed as Brazil.

From a far broader perspective, analysing Brazil as a potential global partner, the country is also not the 'perfect global citizen' it has been often been presented as.

The Brazilian National Interest?

Which isn't to say that Brazil, and its government, aren't doing exactly what they should be doing for the country's future. It is to say that, in so doing, they do not necessarily conform to the desires of other countries. Nor, at any one time, are they inclined to constantly ally themselves with one country or another. Therefore, they have thwarted American ambitions to make Brazil 'their man down south', whilst simultaneously failing to provide the kind of broad support to the likes of Chávez. It is this which may largely be attributed to Lula's decision to greet controversial Iranian President Mahmoud Ahmadinejad. This, in November 2009, was the cause of much international dismay, and prompted US President Barack Obama to telephone Lula and emphasise the need for the international community to present a united front in its dealings with the pariah state, and for Brazil to behave "responsibly" in a manner befitting its newfound place among the world's higher powers. This ignores a point which has become obvious in almost all of Brazil's dealings across the globe. It is no longer a country obliged to follow the agenda of another, having ascended to a level where it can set its own agenda depending upon its own needs and priorities. Thus Brazil will never be the country which kowtows to America, but it will likewise never agree with Iran on all issues.

The strategic nature of the choices the Brazilian Government is making are quite clear. Brazil is arming itself, courtesy of the French, among others. However, whilst the increase in arms purchases in other countries

in the region, in particular Venezuela and Ecuador, have been viewed with a degree of trepidation, in the case of Brazil it is widely perceived that the increase does not reflect a country wishing to present itself as a military aggressor. Instead, observers note, there is a distinct desire on the part of the Brazilians to present a level of force which is commensurate with its position in the world order. Investment in new submarines reflects a desire to protect their new-found oil wealth, whilst the investment in new fighter aircraft is perhaps done with a cautious look towards the decision by Venezuela to rearm.

Whilst the international community at large often talks the words of cooperation, Brazil has emphasised the importance that it is placing upon autonomy. Whilst it is interested in partnerships of strategic interest, the primary goal appears to be a desire to ensure that it is in no way reliant on any one nation for its basic needs, and it is coming tantalisingly close to achieving this goal. It is energy independent, its land means it is able to feed its people, and investment in defence ensures that they will be able to protect their new found gains.

The Future

The Irreplaceable Lula?

In a further indication of why he is everyone's favourite statesman at the moment, Lula has resisted the temptation to follow in the footsteps of Chávez and manipulate his country's constitution to allow himself to run for a third term, a vote he would undoubtedly win. Instead 2010 will see the end of the era of a man who will almost certainly be remembered as one of the most influential, and perhaps the greatest, politicians Brazil has ever had. Many are concerned as to the country's fate when Lula leaves office, but it is worth remembering this: it was not Lula's policies that brought the country to where it is now. Although his continuation of Cardoso's policies is to be congratulated, and whilst it is true that he has provided Brazil with an excellent advocate, he did not introduce many

of the measures which can be held responsible for stimulating the Brazilian economy. Furthermore, he had no hand in the international commodity boom which has also served to spur the country's economy. Which means what?

Hopefully that there is life after Lula. According to polls released late in November 2009, Sao Paulo State Governor Jose Serra, from the opposition Brazilian Social Democracy Party (PSDB), kept the lead in the voting intentions for the 2010 presidential elections. According to the survey, Governor Serra attained 31.8% of the voting intentions for next year's elections. Meanwhile, President Lula's handpicked candidate, Chief of Staff Dilma Rousseff from the Workers' Party (PT), garnered only 21.7%, despite a high approval rating for Lula, who has campaigned vociferously in her favour. Congressman Ciro Gomes, from the Brazilian Socialist Party (PSB), ranked third with 17.5%, and Senator and former Environment Minister Marina Silva, from the Green Party (PV), received 5.9% of voting intentions. It appears likely at this stage however that this will be primarily a race between Serra and Rousseff, with other contenders unlikely to gain the momentum necessary to become viable contenders. Crucially however, they may decide the result by taking away vital votes from one of the main contenders.

Much may change between now and October 2010. Whilst Serra has a strong lead in opinion polls, national name recognition from decades in public office and a power base in Sao Paulo, Rousseff has the backing of Lula and his ruling Worker's Party. Whilst she is far less well known, as her profile grows, she could well claw back support. Furthermore, because of Lula's success, she has a strong platform on which to campaign. Despite its inadequacy for the task of accurately predicting the result of next year's election, the poll result is interesting in that it suggests at an early stage, that Lula's hold over the electorate is not total.

At this stage both of the front runners in the campaign appear committed to continuing, to varying extents, the economic policies of Lula, although Rousseff is likely to follow this more closely than Serra. In terms of the accuracy and value of predictions prior to election, it is worth remembering also, that Lula defied expectations when he became President in 2002, with many international observers fearing that with his union background he would instigate a radical socialist agenda which would be openly hostile to foreign firms, and that whoever follows him, left or centrist, may well do the same.

Conclusion

Brazil, and its people, is at the cusp of a momentous time in its history. But it is wise to remember that the country is not without its faults. There are a number of serious issues, primarily associated with infrastructure, excessive bureaucracy and crime, which must be dealt with if the country is to continue to grow and fulfil its potential, and those in the West would do well not to get lost in the euphoria of the success, whilst neglecting these issues, ignorance of which could have serious success to any project they wish to undertake. However, if sensible policies for both growth and development are followed, funded by the investment of revenue from both the commodity boom, and Brazil's newly discovered vast oil reserves, inspired by an excellent leader, able to capitalise on the optimism of the people, there is no reason to believe that this is not achievable.

In terms of its role in the international community, it may simply be time for the rest of the world to realise that, having found its feet, Brazil's only master is the needs of its people. Now the future depends on he (or she) who has the unenviable task of attempting to fill the shoes of the incomparable Mr Lula.

PREVIEW OF INKERMAN MONITOR JANUARY 2010

China in 2010 will continue to be an economic powerhouse, projected to be the largest global economy by 2030 as it takes an ever-increasing role on the world stage. The January 2010 Inkerman Monitor will seek to address the impact China's record economic growth has had on its international search to ensure growth and stability. The resource hungry nature of its economy is causing it to seek a more active role in international relations which is in turn increasing its sphere of influence over less developed economies in Africa, Latin America and Central Asia. This in turn is increasingly causing friction with western energy companies, the US Government over trade, as well as putting pressure on the financial system during the global recession by helping to set off a global commodity boom. Resource interests are becoming paralleled by strategic and political interests in Central Asia over energy infrastructure and Beijing has spent over US\$50 billion on establishing alternative ways to transport energy resources out of this region in its bid to lock up energy resources. Many of these markets are becoming training grounds for Chinese state owned companies to go global and have vastly increased China's aluminium monopoly, power-transmission duopoly, and major telecommunications companies and airlines reach into new markets because of it. The monitor will also seek to address the pattern set by Chinese state owned companies to invest in markets in pursuit of the Government's long-term strategic interests for raw material contracts or defence related deals to countries with questionable human rights records, and question whether it could continue as China looks to promote greater legitimacy in 2010.

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