### FT SPECIAL REPORT

# **Latin America's Regions Doing Business in Brazil's Northeast**

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# Big projects fuel region's push to keep momentum

The once neglected northeast has been outgrowing the rest of the country but faces a huge task to stay on track, writes *Joe Leahy* 

the future industrial zone, tion works stretches as far as the eye can see.

strong winds whipping up dust from destitute farmers and manual labourthe extensive earthworks recall the ers to the industrialised south in a grand projects of China, a country movement immortalised in masternormally associated with ambitious pieces such as "Os Retirantes" by infrastructure schemes.

complex of Suape in Brazil's northhouse a huge refinery and petrochem-

s the bus enters the site of a port and numerous other activities. It is not only Suape but the entire an expanse of civil construc- northeast region of Brazil that often invites superlative comparisons with China. Once known only as the coun-The vastness of the scene and the try's poorest region, an exporter of painter Candido Portinari, today the This is a long way from Asia, how- northeast is recognised for its high ever. The 140 sq km port industrial growth, with some states expanding as fast as China itself during the eastern state of Pernambuco will boom year of 2010. The question for the region and its politicians is how to ical project, the southern hemi- sustain these high levels of growth at



sphere's largest shipbuilding facility, a time when Brazil's economy as a Cause for celebration: poverty is on the retreat in the northeast

whole is slowing down. "We see emerging regional players," says Hector Gomez Ang, country manager in Brazil at the International Finance Corporation, the private sector investment arm of the World Bank. "You really see companies from the region or that were born in the northeast that are becoming global or national players.

Comprising nine states clustered tightly together, curling along the Brazilian seafront as it juts out into the Atlantic, the northeast is one of the country's oldest centres of European civilisation. It is also a centre of Brazilian culture thanks in part to its strong roots in the country's African heritage. Northeastern musicians include bossa nova singer João Gilberto and his daughter, the contemporary Brazilian singer Bebel Gilberto; and Caetano Veloso and Gilberto Gil, known for the Tropicália cultural movement. Other famous sons of the region include former president Luiz

#### 'You really see companies from the region that are becoming global or national players'

Inácio Lula da Silva, whose family moved from Pernambuco to São Paulo when he was a boy.

The nine states - Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe and Bahia - together represented 28 per cent of Brazil's population of 191m people as of 2010, but they contributed only 13.4 per cent of national gross domestic product in 2011, according to the latest figures available from the national statistics agency.

In the 10 years between 2002 and 2012, poverty declined more rapidly in the northeast than on average in

Reuters

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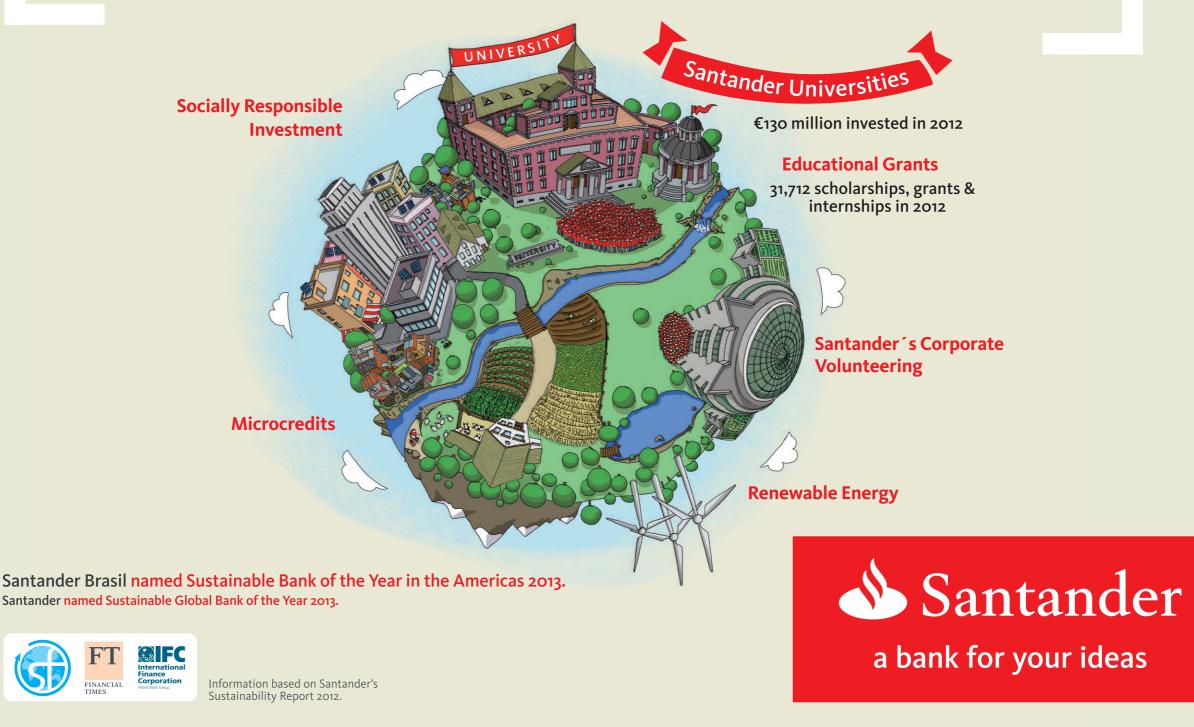
#### Soccer kickstart

World Cup arena in Pernambuco state will be part of wider regeneration Page 4

Santander named by Financial Times

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Dozens of states

### **Doing Business in Brazil's Northeast**

# Public-private partnerships help transport get back on track



Column **RICHARD LAPPER** 

Few projects better illustrate the frustrations of Brazil's efforts to develop infrastructure than the urban railway under construction in the sprawling northeastern city of Salvador. Since work began 14 years ago, the multibillion-

dollar plan has been beset by difficulties. Yet over the past few months there have been signs that a saga of incompetence and mismanagement is reaching a conclusion.

It is possible that a 6km

stretch will be open in time for the World Cup match between Spain and the Netherlands on June 13. That should pave the way for the completion of the 36km metro scheme over the next four years. Delays to Brazilian

infrastructure projects are

and frustrating, given the

poorest and most socially

For the conservative

administrations that

presided over the city's

rapid expansion in the

1970s and 1980s, ugly

abysmal state of public

commonplace, but those

that have dogged

divided cities.

local business interests controlled the competing bus companies that took residents from the poor northern suburbs to work in the better-off south of the city.

As Rui Costa, chief of staff of the leftwing state government of Bahia, puts it: "Public transport has Salvador's metro have been never been on the agenda particularly mind-boggling before." The metro has been flawed since its conception. The first provision in one of Brazil's planned line covers a narrow area towards the centre of the city, and even when complete would leave most commuters dependent on overcrowded buses Management of the project was handed over to

were a priority. Myriad

multi-lane urban highways the Salvador city government, a body that designed to meet the needs of middle-class car owners could not hope to assemble

the financial resources for development.

During the 2000s, work was interrupted repeatedly by financial and political problems.

Although the Lapa-Retiro stretch was finished in 2008 and bright new trains delivered in 2010, the municipality could not afford to meet the running costs of the line. Consequently, rails deteriorated and rolling stock was mothballed. A stand-off between a populist mayor and the pro-government state administration led to further delays. It was only last year after a new image-conscious rightwing city government came to an agreement with Mr Costa's colleagues in the state government that

progress has accelerated. In October, CCR, a Brazilian toll road builder and operator, won a build-

and-operate contract to complete the work. It has promised to double the length of the first line and is pledged to complete a second line by 2017, which will link Salvador's centre with its international airport 25km away. It would be easy to be

cynical, however. Some of the progress is certainly due to the World Cup. After all, Brazil is pretty good at the short-term mobilisation of resources for sports events, international conferences or carnivals. But longerterm sustainable improvement has been much more challenging During the 1980s and

1990s, it was mainly a question of budgetary constraints on public investment.

Under the leftwing governments of Luiz Inácio Lula da Silva (2003-10) and Dilma Rousseff (2011present) infrastructure has been a priority, but progress has been patchy. Projects become mired in bureaucracy, environmental licences can be hard to obtain and it can take considerable time to

Public prosecutors and government auditors often stop works apparently on a whim

acquire land. Public Ms Rousseff has privatised five of the prosecutors and government auditors often stop works country's largest airports apparently on a whim. over the past two years. Although public-private After bowing to business co-operation is now the pressure for better terms, order of the day, leftist the government has auctioned off contracts to officials have sometimes resisted change build and operate more For example, Brazil's than half a dozen inefficient publicly owned highways over the past

railway company retains a year. key role in the project to build much needed freight and municipalities have lines that could transport been making reasonable soya and mineral exports progress too, with a more efficiently to port. number of metro, monorail Almost no progress has and bus rapid transit been made. schemes, in which articulated buses circulate There have been some advances. however. Several

along dedicated traffic reasonably efficient lanes, under construction. privately owned, publicly listed infrastructure The writer is principal of concession companies -FT Confidential. an such as CCR - have *emerging* markets investment research service

Suape refinery wins political support despite escalating cost

**Energy** Petrobras project cost soars sixfold but plant creates 40,000 jobs and attracts other industry to port complex, reports Joe Leahy

ix years ago this month, Bra- be Petrobras' largest producer of dielate Venezuelan counterpart, Hugo Chávez, were pictured shaking hands at the site of Brazilian total refining capacity and it is hoped energy group Petrobras' new refinery in Suape, Pernambuco state.

The red dirt of the construction site of the Abreu e Lima refinery was sup- grown for petrol, led by the growth in posed to be ground zero for a closer

zil's former president Luiz sel, with 70 per cent of its planned Inácio Lula da Silva and his capacity able to process the fuel. Once fully operational, the plant will represent 11 per cent of Brazil's it will help reduce the country's dependence on refined fuel imports. As demand in the country has

the number of trucks and cars on the



# Retail boom acts as stimulus for investment

**Consumer markets** 

emerged.

Companies target shoppers from new middle class, reports Samantha Pearson

For Gilson Alexandre, a 42year-old truck mechanic, there is nothing better than spending an afternoon at the local shopping centre. "It has everything you could want," he says,

browsing the food court of Shopping Recife, one of the largest retail centres in the northeastern Brazilian city. With more than 450 shops, 19 restaurants, 10 cinema screens and plenty of benches on which to take a nap in the comfort of the

about 65,000 people a day. Visiting shopping centres has become a national pas-Other time in Brazil. Aside from grammes have boosted conbeing somewhere to meet sumer spending, such as friends and family, they are "Minha Casa Melhor" ("My a relatively safe place to Better Home"), which gives hang out in otherwise danlower-income families a gerous cities, thanks to four-year loan of up to heavily armed guards on R\$5,000 (\$2,174) to buy home the doors. appliances and furniture. Demand for new shopping Families are only eligible

the rest of the country.' However, the northeast's consumer boom is also a result of concerted efforts by the federal government to accelerate the region's development.

"In spite of the necessity of [public investment in the northeast], the decision to focus on the region has been a political one," says Otto Nogami, an economics professor at São Paulo's Insper business school.

The Bolsa Família welfare programme, a cornerstone policy of the ruling Workers' Party (PT), has been responsible for lifting millions out of poverty over the past decade and has helped keep the PT in power since 2003. Mr Meirelles estimates

government pro-

that more than 40 per cent building's air conditioning, of families in the northeast Shopping Recife attracts receive the stipend, making the region a loyal base of political support.

energy relationship between the two neighbours and their populist governments, with Venezuela supplying the oil and Petrobras doing the refining.

However, it was not to be, and late last year, Petrobras took over full responsibility for the project, which will cost an estimated \$17bn (up from an original \$2.7bn).

"The unit's products will be destined predominantly for the northeast market," the company's website said. "At the moment, the project is generating 40,000 jobs directly and is being constructed with 86 per cent local content.'

The sheer size of the project, which, once completed, will provide 230,000 barrels a day, and the fact that it is Brazil's first new refinery in years, have increased enthusiasm in the northeast for the petroleum industry.

The plant is also acting as a strong anchor tenant for the Suape port industrial complex, with a petrochemical unit also planned to come on stream, and shipbuilder Estaleiro Atlântico Sul constructing vessels for Petrobras' oil exploration and production arm.

"The northeast is growing from a lower starting point but it is the fastest-growing part of the country and the main entry point is the port of Suape," says Peter Gyde, Brazil managing director for Maersk Line, the world's largest container carrier.

Half of the refinery's capacity will be delivered in November this year, with the other half due to come on stream in May 2015. The refinery will

roads, the ability of its refineries to supply this fuel has lagged behind.

According to the US Energy Information Administration, total primary energy consumption in Brazil has grown by more than a third in the past decade because of sustained economic growth. At the moment, the country has 1.9bn bpd of refining capacity spread across 13 facilities, 11 of them operated by Petrobras.

"Petrobras plans to increase its Brazilian refining capacity to more than 3.2m bpd by 2020 to meet burgeoning domestic demand," the EIA says, adding that this includes plans for five new refineries, including Abreu e Lima.

The other vital aspect of Petrobras' presence in Pernambuco is Estaleiro Atlântico Sul, which is a big part of the government's programme to increase the oil producer's use of domestic content in equipment.

This policy was boosted by Petrobras' discovery of huge oilfields off the country's southeast coast. The expected production increase from these fields should provide the cash to subsidise domestic production of equipment, which is generally much more expensive than imports.

President Dilma Rousseff, who in an

It is hoped the plant will reduce Brazil's dependence on refined fuel imports

earlier role was energy minister under her predecessor President Lula da Silva, visited Suape in December to attend the inauguration of one of the Estaleiro Atlântico Sul's most prized products to date, the P-62 floating oil platform. Built by 5,000 workers over three years at the shipyard and weighing 60,500 tonnes, it cost R\$2.6bn (\$1.1bn) and has a processing capacity of 180,000 bpd of crude oil.

Suape has contributed to rapid growth in Pernambuco, ironically for Ms Rousseff and her Workers' Party, boosting the career of the state's governor, Eduardo Campos, who will stand against her in presidential elections this year.

But the exorbitant cost of some of the government projects, such as the Abreu e Lima refinery, has also attracted critics, who believe the government is squandering taxpayers' money on bloated public projects.

Responding to such concerns on its blog, Petrobras said the Abreu e Lima refinery exceeded initial cost estimates because these were made when

the project was in the very initial Lifting phase of evaluation. It said that as the project developed, a clearer estimate of costs emerged.

The budget for the project was also swollen by "exchange rate adjustments and the overheating of the equipment market, among others, that caused the value of the investment to increase during the evolution of the project", Petrobras said.

"Various factors contributed to the changes in estimated delivery times, among them the necessity to hold new tenders because of excessive prices. Other factors were strikes. environmental conditions and the construction of infrastructure to access the project," Petrobras' blog continued.

zuela – in spite of Mr Chávez and Mr Lula da Silva's apparently warm relationship - failed to live up to its promise of investing alongside Petrobras, leaving the already heavily financially burdened Brazilian company to take up the slack.

## Big projects fuel region's push to keep momentum

duce petroleum derivatives.

ports

Nearby is the Estaleiro

#### **Continued from Page 1**

Brazil. The region's middle class grew from 22 per cent of the population to 42 per cent, compared with growth in the national average from 30 to 52 per cent during the period, according to government data. This was thanks partly to a steady increase in household income per head of 3.9 per cent a year in the two decades to 2012, according to government research institute Ipea

Even as Brazil's economy has slowed down, parts of the northeast have continued to outperform. Pernambuco, for example, grew 2.3 per cent in 2012 – more than twice the national rate of 0.9 per cent.

But the region still suffers from the country's worst illiteracy rates, at success has been based on more than 15 per cent of the Chinese-style model also succeeded in diversify-

those aged 15 and over – of setting up industrial although this is improving zones to attract clusters of and has most of the companies.

nation's extremely poor people (classified as those living on up to R\$70 (\$30) a month). As of 2010, 9.6m of a total of 16.3m extremely poor Brazilians lived in the northeast.

"In general, we see that the northeast is [still] poorer. Its [social] indicators are worse, but they have improved much said <mark>Marcelo Neri,</mark> more, minister and head of Ipea – and known as Brazil's fore-

most specialist on the middle class – during a press trip to the region last year. The northeast's three engines of growth are Bahia state and its capital Salvador. Pernambuco and its capital Recife, and Ceará and its biggest citv Fortaleza. Part of their

ing from old heavy industry into new technology sectors. Recife has the Porto Digital,

In Suape, for instance, a district of high-technology Petrobras, Brazil's statecompanies located in the controlled oil company, is city's old port area, while investing about \$17bn in its the region's high winds and 230,000 barrel per day intense sunshine are stimu-Abreu e Lima refinery. lating growth in renewable There will also be a petroenergy businesses. chemical complex to pro-

Some of Brazil's most prominent companies have

#### Atlântico Sul, a shipbuilder 42% controlled by Brazilian construction groups Camargo Corrêa and Queiroz Galvão,

#### Middle class as a proportion that is producing a fleet of of the northeast's population

vessels for Petrobras. The their roots in northeastern complex is also home to numerous other companies business families, including specialising in logistics and Odebrecht and Queiroz Galvão, the construction Other so-called pólos or companies. But new ones clusters include steel and are emerging too, including Coca-Cola's bottlers in the pharma-chemical industrial zones in Pernambuco, and region, Guararapes, Norsa another petrochemical clusand Renosa, which followter in Bahia. The region has ing a merger will become the second-largest producer

for the beverage maker in challenge, he adds. The Brazil, with a reported business culture can be R\$6bn in revenues. quite insular for a region Stacked against these that needs to attract outside opportunities is what the capital to grow, although

future will hold for the that is changing as a new northeast once the congeneration of business leadstruction boom associated ers emerges. with its megaprojects ends. The region lacks semiskilled, skilled and highly qualified labour, even though it is attracting technology-intensive industries that traditionally were the province of the richer south, such as automotives prompt growth.

and chemicals. "One of the key challenges... is what is going to happen after those construction jobs are gone," says Mr Gomez Ang of the IFC. "What are people going to be doing and where is the job generation going to come from?'

The lack of large private sector lenders to help spur growth provides another expectations: Petrobras now has full control of the Suape project Getty Images

Against its drawbacks,

American

in health.

centres is strongest in the country's poorer northeast region, which until recently had been largely neglected by developers. As consumer spending begins to slow across the rest of the country, the region's nine states remain a bright spot for retailers, as millions of Brazilians enter the middle class for the first time. As of December last year,

32 shopping centres were

Luís Augusto Ildefonso da

of the national retail associ-

157 over the same period.

"Many of the new shop-

ping centres [in the north-

ation Alshop.

centre.

barren

home via 'Social mobility in Brazil is shown through the capacity to

consume

under construction across government's "Minha Casa Brazil's northeast, up from Minha Vida" ("My Home, 30 at the end of 2012, says My Life") programme.

for it if they bought their

the

The region's consumer boom has encouraged many Silva, institutional director firms to build factories in the region. O Boticário, one The number of shopping of the country's most popucentres being built nationlar cosmetics chains, is to ally decreased to 153 from open a production plant and distribution centre this year in the state of Bahia at a cost of R\$535m. The factory east] are in smaller cities will serve as a base for the that don't already have whole of northeast and north Brazil.

one," says Mr Ildefonso da Silva. "It is hard to go International consumer wrong when you are buildgroups have also ventured ing a city's first shopping into the region. In 2011, Kraft opened a factory in To a large extent, the Pernambuco - its first in northeast is simply catchthe northeast - to produce chocolate and powdered ing up with the rest of Brazil. Lumbered with a vast, drinks. Upmarket brands hinterland and such as Pernod Ricard's located thousands of kilo-Chivas Regal whisky have metres from the country's also found success, as the region's new middle classes southern centres of power, the northeast has long start to spend. In 2012, the ranked as the poorest and company ranked Recife as the top market in the world in terms of per capita

least developed region. Despite the recent growth, development indicators in whisky consumption. some parts of the region are still comparable with those

new infrastructure, such as However, this is what planned railway links with the interior of Brazil that makes the northeast one of will provide an alternative the country's most promisto southern ports for soy ing consumer markets, says farmers looking to export Renato Meirelles, president their produce, will help of the Instituto Data Popular, a consultancy.

"The ownership of televi-The IFC has already invested about \$1bn in 10 sions, mobile phones, comprojects, including helping puters, washing machines to advise alongside the Braand other goods is lower in zilian Development Bank the northeast than across (BNDES) and the Interthe rest of Brazil, so there is Development a lot of pent-up demand," Bank on Hospital do Subúr-Mr Meirelles says.

bio, a medical facility in an "Like the rest of Brazil, underserved part of Salvathe northeast will grow dor that was Brazil's first at a slower rate than in the past decade, but the region public-private partnership will still grow faster than

"This is a sign of social mobility, which in Brazil is of African countries. shown through the capacity to consume," says Insper's Prof Nogami. However, for producers of higher-value durable goods such as home appliances, it still does not make sense to

build a factory in the northeast, he says. "You will find strong demand in the state capitals but not outside the cities the market is not mature enough," Prof Nogami says, adding that the northeast's

logistical problems and lack of skilled labour can also drive up companies' costs.

"The region has huge potential, but it is still only that," he says.

Politics too played its part, as Vene-