

# WHARTON *on* Global Markets



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# Global Business Trends

Call them the darlings of the global market—the economies of India, China and Brazil have exploded in recent years, igniting both business opportunities and challenges. These countries are learning to balance the benefits of their rapid development with the inevitable concerns that accompany fast growth. India faces a shortage of workers in the most advanced professions, such as engineering and medicine, and, along with China, must find ways to spread concentrated pockets of wealth to its rural, impoverished areas. Brazil is enjoying a real estate boom that could entice continued foreign investment, as long as issues like the energy crisis don't lead to market volatility. How are these countries managing their emergence? The following articles from *Knoweldge@Wharton* examine that question.

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In the more than 25 years since it made its debut, the term 'emerging markets' has come to define any and all countries that are undergoing rapid economic change. As one observer puts it, the term 'emerging markets' has become a victim of its own success. But has it lost its significance in helping to define the growth of the global economy?

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Along with China, India and Russia, Brazil is a country overflowing with opportunities to attract foreign capital. In 2006, it was the third-largest economy in the western hemisphere and the 11th largest in the world. "It is a country where you have to be," notes one expert. Nevertheless, Brazil must continue with reforms underway in order to maintain its upward momentum.

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### Brazilian Real Estate Is Having a Ball

Brazil's real estate market has continued to grow, fed by the country's economic and political stability, a powerful reduction in interest rates, and measures taken by the government to provide incentives for civil construction and home buying. Foreign investors are planning to build shopping malls and buy land at prices that are still cheap. So, what could ruin the Brazilian real estate festival?

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P. Chidambaram, India's finance minister, sounded confident as he spoke about his nation's surging economy—currently growing at more than 9% annually—at a recent Wharton Leadership Lecture. But he also predicted that rapid growth won't last if the gains are not shared by hundreds of millions of Indians still mired in isolated, poverty-stricken villages.



# When Are Emerging Markets No Longer ‘Emerging’?

*The term “emerging markets” is now more than 25 years old and has come to define wide swaths of the world undergoing rapid economic change.*

Dozens of countries fall under the label even though they are evolving at their own pace and with their own twists on economic development.

Now, as many emerging markets show signs of a strong and growing middle-class population, observers wonder whether the term has lost some of its meaning. Initially, the phrase applied to fast-growing economies in Asia and was used in Eastern Europe after the fall of the Berlin Wall. As global interest in market-driven economies grew, investors began to look toward Latin America for emerging markets and eventually at countries such as Indonesia, Thailand, China, India and Russia.

“Once you start to put so many countries in the same category, the category loses meaning,” says Wharton management

professor Mauro Guillen. “While South Korea, Singapore and Taiwan share characteristics, once you put them in a bucket with India, Mexico, Argentina, Indonesia and Poland, it’s no longer meaningful. The term ‘emerging markets’ has become a victim of its own success.”

Wharton management professor Gerald McDermott agrees the definition is muddy, but the intent behind the phrase remains the same. “People started using it more loosely, and as more countries fell under the rubric, it lost a little bit of its original meaning,” he says. “I think it continues to convey a reality that we’re not talking about the developing world at one end or the developed world at the other. We’re talking about countries with great promise and great potential. They’re growing, but they’re still not there.”

## Looking Down on the ‘Third World’

Antoine W. van Agtmael was deputy director of the capital markets department of the World Bank’s International Finance Corp. (IFC) when he coined the phrase “emerging markets” during an investor conference in Thailand in 1981.

Van Agtmael recalls that back then, Thailand was grouped with other poor countries that were known as the “Third World.” He felt that name was discouraging investors from putting funds to work in Thailand and other poor countries with development potential.

“People looked down upon the ‘Third World.’ It sounded so distasteful. I thought people with that feeling would never invest,” he says. “I had lived in Thailand and I knew it was better than people thought. I felt we had to use a more uplifting term.” Initially, the definition applied to stock markets in countries with a cutoff of \$10,000 in income per capita. Those specific numerical references soon faded. The term “emerging markets” came to be synonymous with “emerging economies” and no longer relied on income or other statistical measures.

According to Wharton faculty, the most important element in defining an emerging economy poised for growth is the strength of its economic and political institutions, such as the rule of law, regulatory controls and enforcement of contracts.



China, I would be really careful that I establish the rules, rather than just relying on institutions that say they are open to strangers,” says Nichols. “China is definitely moving toward formally-run institutions and the same is true of India. But you would be pretty foolish to just rely on a contract, although India is farther along than China.”

Countries that make it into the top rungs of economic progress can slip backwards, too. Guillen notes that in the first part of the 20th century, Argentina was one of the richest nations in the world. After decades of Peronist rule and decline, Argentina became a star in the 1990s march toward privatization, only to stumble into a financial crisis in 2001. With a well-educated population and wealth of resources, Guillen says, “Argentina is one of the biggest mysteries.”

Lebanon is another example. In the 1960s, it was considered to be the Switzerland of the Middle East, with strong trade and high per capita incomes before it descended into Civil War, never to recover its economic place in the world.

“There are many examples of African countries that were doing reasonably okay and then got into trouble,” adds Guillen.

### Forever Emerging?

Even with their weaknesses, emerging economies are clearly a rung up the economic ladder from many other countries, including most of sub-Saharan Africa, Central America, Haiti and the Dominican Republic, along with Bangladesh and Myanmar, Guillen says.

At the same time, some countries seem to have gotten solidly stuck in the

emerging markets category. Guillen points to South Korea, where per capita income is \$20,000—well above most countries in Latin America and South and East Asia. More important, the economy has transformed from a heavy industrial base to a strong focus on knowledge and technology. “One thing that intrigues me is these countries seem to be emerging forever,” he says. “It’s about time we think of South Korea as a fully developed economy.”

Guillen is careful to emphasize that there is no one path to economic prosperity. “All countries start in different positions. If they succeed, they do so in different ways,” he says.

Bert van der Vaart, CEO of Small Enterprise Assistance Funds, a global investment firm providing capital and support to 29 emerging markets, says the sector is increasingly recognized as an investment class that should command 5% to 15% of total assets. “Growth in these countries is likely to be trending positively and in excess of the OECD average. In a sense, these economies are “catching up.


His definition excludes a number of poorer countries whose governments are not willing to adopt true market reforms, or where the ruling elite are doing well enough that they do not care about attracting a broad range of private investment. Zimbabwe, for example, despite all its human and physical resources, falls short of being an “emerging market,” van der Vaart says.

More than a quarter century after he christened the term “emerging markets,” van Agtmael, now CEO of Emerging Markets Management in Arlington, Va., which manages \$20 billion in institutional investment, says he has seen tremendous change. “We are in the midst of a huge

shift in the global economy toward emerging markets, as many are no longer poor, but are becoming middle class. The emerging markets consumer is becoming increasingly important, infrastructure spending in emerging markets now exceeds that in the U.S. or Europe, and a steadily larger group of companies is becoming world class.”

According to van Agtmael, in the next 10 years there will be one billion more consumers in emerging markets, and in 25 years the economies of these countries will surpass the combined economies of the developed countries.

In recent years, Goldman Sachs has contributed to the economic name game. In 2001, the firm began calling Brazil, Russia, India and China the “BRIC” countries and forecast that by 2010, they would make up more than 10% of global GDP. By 2007, they already accounted for 15%. Then in 2005, Goldman Sachs introduced another moniker, the Next Eleven (N-11), identifying another set of populous countries with the potential to have an impact on the global economy, similar to the BRIC nations. The N-11 are Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam.

Van Agtmael says he has heard some new terms—“middle-income emerging markets” or “graduating emerging markets”—tossed around to describe countries moving up the continuum. “Now most investors simply realize there’s money to be made in these markets—not just the portfolio investors, but also major corporations. The name is now less important than the fact that people recognize this is a part of the world that is no longer a backwater and no longer peripheral, but an increasingly important part of the world.” 

# Brazilian Real Estate Is Having a Ball



## *Mauro Costa no longer lives in a rented apartment on the periphery of São Paulo.*

He is one of the 204,312 Brazilians who, over the last 12 months, realized their dream of purchasing their own house. The debt he acquired for financing the house will have to be paid off over the next 30 years at an annual interest rate of 12%. But Mauro is enormously happy nevertheless. Not long ago, before the Brazilian government changed its regulations for real estate financing, he could not even have imagined holding the keys to his own house in his hands.

Mauro's story provides an example of the new reality that the Brazilian real estate market has been experiencing ever since the middle of 2005. With continued stability and economic growth, the

market has recorded positive growth since 2001, according to Abecip (the Brazilian Association of Real Estate and Savings Institutions). Until recently, however, the market lacked regulations that made conditions for purchasing real estate more flexible. These changes were carried out by the government in 2005. Ever since, loan activity in the sector has shot up. In 2004, 53,787 real estate loans were made in the country, according to Abecip. In 2007, that number reached 195,900.

"The changes revolved around real estate guarantees," says Jose Carlos Oliveira, professor of economics at the UNB (University of Brasilia.) "In past cases of non-compliance, the person responsible for the financing did not recover an adequate amount. Starting with 2005, the government permitted institutions to work with "fiduciary alienation," an arrangement

where the buyer of the property becomes the owner of the property only after he has just paid it off. Although this option creates a highly risky situation for the borrower, it makes it possible for the person who provides the funds to have an additional motivation" because it permits him to recover the property in case of non-payment.

Once the institutions that granted loans had more security, the government could expand the options for obtaining funding. According to the regulations of the Brazilian central bank, 65% of all the government's savings had to be used to provide housing credits, as specified by conditions set by the SFH (the Housing Financing System, which caps interest rates for acquiring and constructing housing to 12% and 13%, respectively). The rest of the credits had to be provided at market rates and used for financing

residential real estate. “These measures were designed to set up a specific budget from various governmental sources, and they encompass the expansion of credits for the financing of housing and the reduction of taxes on industrial products and a broad range of construction materials,” adds Anita Kon, professor at the PUCSP, the Catholic Pontifical University of São Paulo.

Adds Kon: “The private financial sector also implemented measures to provide incentives for increased real estate financing. It lengthened the time periods allowed for financing and made the regulations more flexible for verifying the incomes of borrowers.” Currently, payment conditions are more stable, and financial institutions have reduced the requirements when it comes to providing proof of income. Even self-employed workers and small entrepreneurs can get financing based on conditions offered by the SFH, whose funding is subsidized by the government.

Despite this growth scenario and favorable real estate market conditions, Kon believes that this phenomenon still cannot be defined as a boom. However, Antonio Montes, professor at the Instituto de Empresa in Spain, is much more optimistic. In his opinion, the development of the country has made possible the relocation of the rural population to the big cities. This trend is increasing the demand for housing in the large urban centers. “Brazilians who don’t have housing are thinking of buying rather than renting. In the past, they could not do that because they didn’t have access to credit. This change has produced a democratization of the real estate market,” he says.

However, not every Brazilian social class is equally enjoying the larger housing supply. Kon explains that although the government has dedicated specific funds for the lower and middle classes, the biggest beneficiaries of the real estate boom are upper-middle-class and upper-class buyers. “At this level, the housing supply is very high, which leads to strong competition among sellers and makes business opportunities more flexible. On the other hand, even though there are funds specifically aimed at the lower class, a very large part of the Brazilian population is on the fringe and doesn’t

have the buying power to take on these loans.”

One significant factor in this scenario—and the key difference between Brazilian conditions and those in the U.S.—is that the Brazilian system is growing stronger. The Brazilian middle class is going through a prosperous period, with growing indexes of income and employment. One sign of that is in recent data from the Caixa Economica Federal (CAIXA), a government bank, showing that those people who are younger than 30 accounted for 36% of the real estate financing deals provided by that institution in 2007. “What happened in the U.S. will not occur in Brazil, at least not now,” says Oliveira. “In the first place, that’s because the lower and middle-lower classes are not active in this market. And interest rates aren’t so low that they’ve reached the point of stimulating people who don’t have the potential to buy and sell.”

### Foreign Investment

Domestic buyers are not the only players in this ongoing festival. Foreign investors, notes Montes, “have become aware that they can continue to expand in countries like Brazil. That’s because of the real estate crisis in the U.S., stagnation in Spain and the general slowdown in all of Europe.” One of those investors is José Antonio Sánchez Santamaría, a Spanish entrepreneur who has begun to construct a 2,000-hectare tourism complex in Natal in the Brazilian state of Rio Grande do Norte. Known as Grand Natal Golf, the complex has as its public faces Antonio Banderas, the Spanish actor, and Ronaldo, the Brazilian football player.

Santamaría launched his project after building 40 promotional housing units that tested demand from foreign investors. So far, his company has put on sale 90% of the area of the Natal tourism complex, where up to 30,000 residential units will be constructed along with five golf courses, various athletic centers and eight hotels. All of this will be managed by an unnamed partner that is a “Brazilian industrial company,” the president of the Sánchez Group told the media at the end of last year.

As Montes explains, “There is a growing demand from people who want to have their second homes in Brazil because it is

such an attractive country. It is economically and politically stable, and it is developing important infrastructure projects in its ports, airports, highways and railroads. This fact, along with the current level of international confidence in the country, is attracting a lot of foreign investors.” Every year, an estimated 7 million tourists visit Brazil. About 5% of them want to have a second residence there. In the Northeastern region alone, 80,000 houses and apartments will be built over the next eight years, expressly for foreigners.

In that region, notes Montes, property values have more than doubled over the last year. “Add to that, Lula’s 2006 plan that contemplates using up to 32% of fiscal surplus for real estate investments. Also, taxes have been reduced on construction materials. Labor is cheap, and interest rates have dropped a great deal, from 25% to 12%, and they continue to drop. Prospects are very positive.”

Regarding accelerating sales growth in various regions, “This was initially more intense in the region of São Paulo, which is the center of Brazilian development, as well as in Rio de Janeiro,” notes Kon. “Nevertheless, other parts of the center and the Northeastern part of the country are preparing themselves for accelerated real estate sales.” The strong bureaucracy, along with the centralization of decision-making in the Southeast and Southern regions of the country, Kon adds, “has made it more difficult to stimulate the rest of the regions.”

On the other hand, Juan Ignacio Sanz, a professor at ESADE, believes that we can indeed talk about a real estate boom in Brazil. Compared with other alternative investments aimed at Spanish private investors in recent months, such as in Morocco, investing in Brazil is much more attractive because it is typically tropical tourism yet it benefits from the improvements in low-cost communications, he says. From a cultural viewpoint, he adds, “there is greater proximity to Latin America than with African countries, particularly those that are Islamic, which favors longer-term investments in Brazil in contrast to shorter visits in northern African countries.”

### The Consolidation Process

According to Montes, prices in the

residential and commercial real estate markets are going to shoot up over the next year, “if they continue to reduce interest rates, contain inflation and the growth rate continues to be stable. I think that there can be a significant surge in prices. So you have to take advantage of the investment opportunities now. There are a lot of international real estate funds that have their eye on Brazil. They are anticipating that Brazil will be granted “investment grade” status by risk assessment specialists. That is something that is very likely to happen within a few months.”

At the moment, most of the companies that compete in this market are Brazilian. Montes notes that the sector is consolidating. “When they began to talk about the growth of the sector, many companies wanted to issue shares on the stock market so they could undertake grand projects. The real estate market shot up after that. Some companies took a wallop but others survived. By the end of 2008, we’ll see what the results of the consolidation are.” Montes predicts that the big companies will survive, along with those firms that specialize in one specific sector.

In the current consolidation process, a large number of small construction companies are also growing, and they are confident that they will continue to make money. A quick walk through São Paulo, for example, makes it clear to visitors that many real estate projects will come onto the market during the next few years. “The market continues to show strength because the entire process is still very cheap. Land is very cheap in Brazil. Whoever makes an investment on a certain scale in this country will still make a lot of money,” adds Oliveira.

### The Latin American Context

In Latin America, notes Montes, three countries are comparable from the viewpoint of real estate—Chile, Mexico and Brazil. These countries are less risky for investors, for a series of different reasons. In Chile, he explains, “The overall population has become wealthier, which means that everyone can acquire housing thanks to political stability. There isn’t much of a market for tourists or foreign investors.”

Mexico is “very similar to Brazil, but it is a lot more influenced by the fact that it is

on the border with the U.S.” Montes notes that there are even people who work in the Southern part of the U.S. and have a residence in Mexico because it is cheaper, Mexican taxes are lower and so forth. Mexico also has important tourism centers and large shopping malls, as does Brazil. In those two countries, Montes adds, there are great

“There is a growing demand from people who want to have their second homes in Brazil because it is such an attractive country.”

concentrations of population and cities where security is an elaborate issue, as you can see from walking down the street and looking at the European-style shops. In both countries, U.S.-style shopping malls are popular. On the other hand, he adds, huge companies, such as Spain’s Fadesa, are buying large office buildings in Brazil “because the investment is enormously profitable, on a day-by-day basis.”

Montes notes that foreign investors have also shown a great deal of interest in renovating buildings in Rio de Janeiro. “In some abandoned ships in the port area, for example, companies have converted space into deluxe apartments and shopping malls.” However, he warns people that they “must take along a map from the government or the respective municipality, and the security arrangements must favor foreign investors who want to stay there.” In addition, it is important to note the bureaucratic obstacles that can arise at the last minute.

According to Montes, prices will increase at a spectacular rate. “A rental property [that you lease to someone] in Spain provides you with profitability of from 2% to 5%. In Brazil, you can get three times that much. In addition, according to the Lula plan, the largest airport in Latin America will be

built in Natal, which will make that city only six hours from Madrid and five hours from Lisbon. It will have a capacity of about five million passengers.”

### Prospects for the Short, Medium and Long Term

Kon believes that real estate sales in Brazil will continue to grow over the short term, with the country passing through a stage of industrial acceleration, especially when it comes to building materials. This will have a considerable multiplier effect on employment and income.

Nevertheless, Kon notes, “in the medium and long term, this movement is not sustainable since the supply of real estate for the medium and upper classes is growing in a way that exceeds demand.” Over the medium and long term, “there is a major chance that the net assets of the less privileged classes will decline since there is a need to give priority to other basic infrastructure projects and to other social problems, such as education and health projects, that support development.”

Montes is much more optimistic. For him, the major risk revolves around knowing whether the Lula government will continue all the structural reforms that it has initiated and still has in the works, as well as whether it is able to battle against corruption and the shortage of security. Another danger is the energy crisis, which could affect the domestic market.

Oliveira notes that the Brazilian government is working hard to create fewer barriers to investing in the manufacturing sector, and to make it easier for foreigners to enter the Brazilian market. According to Oliveira, these types of investment will make it more attractive for foreign investors to come back to the market, as positive conditions in the country reduce the risk of massive capital flight. “The government is working on regulations that do not restrict foreign investment in liquid assets, but which provide incentives for investing in real assets both in the manufacturing sector as well as civil construction. These regulations should not be extremely rigid, or they will alienate investors. They should help avoid volatility.” 🌐



# Why Brazil Has Become One of the Top Four Investment Destinations in the World

*Along with China, India and Russia, Brazil is a country overflowing with opportunities to attract foreign capital.*

Brazil is leading the way in Latin America's economic development. In 2006, it was the third-largest economy in the western hemisphere and the 11th largest in the world. The economy has stabilized, the legislative reforms of the Lula Da Silva government are boosting cooperation between the public and private sectors, imbalances are improving, and the high valuation of markets is attracting the attention of foreign investors.

As a result, the Brazilian currency, the real, as well as the country's stock market are both at all-time highs. "If you want to be in Latin America, you have to be in Brazil," notes Rafael Pampillón, professor of economics at the Instituto de Empresa business school in Madrid.

## Lula's Success

Rediscovering Brazil as a financial destination for foreign business has

become a huge challenge. Under the leadership of President Inacio Lula Da Silva, Brazil continues to strengthen its favorable business climate for foreign investors. "The key to Lula's success has been to achieve sustained growth without undertaking populist adventures or struggling to combat the country's poverty," notes Juan Carlos Martínez-Lázaro, professor of economics at the Instituto de Empresa.

One of the keys to Brazil's international success is the political stability of its government. The reform programs being carried out have been a success, enabling the country to lessen its vulnerability. "Lula has been a big surprise," says Martínez-Lázaro, adding that initially, there was a "great deal of distrust. But he surprised everyone. His big success was to pursue a policy of fighting his country's poverty, not by undertaking populist policies but through macroeconomic stability." For Rafael Pampillón, Lula has been the person "at

the forefront of the country's progress and stability."

The huge size of the market, the successful privatization program, the remarkable diversification of its manufacturing and export sectors, and its strong political democracy have become the pillars of Brazil's dynamic economy and society. "Brazil is close to Chile, Peru and Mexico," notes Pampillón. "It believes in globalization and it thinks that opening markets helps promote growth, not through the populist road followed by Ecuador, for example."

The Brazilian government wants to guarantee stability through prudent budgetary policy and monetary policy

Growth is getting stronger ... and there are good reasons to believe it will last a long time," says Martínez-Lázaro.

### The Stock Market's Appeal

For more than 20 years, Brazilian capital markets were characterized by protectionism and underdevelopment. Following the improvement in the economy, capital markets began to modernize. Lately, Brazil has been benefiting from a favorable external environment. On a global level, it has significant liquidity. In a broad range of financial markets, prices have risen at a brisk pace and the country has growing economic ties with developed economies. Internally, its monetary

markets. The economic crisis in Argentina, along with the arrival of Lula as president of Brazil, frightened away capital investment. The profits offered by Brazil, Argentina and Mexico could not compete with those in Asian markets. But the situation has changed. Analysts say that the rise of Latin American markets can be explained by the favorable international environment. "The exchange rate is variable. If global economic conditions change and Brazil doesn't attract enough foreign capital, the exchange rate will adjust, which will lead to adjustments in the country. Now that it is a country on the rise, the exchange rate has gone up and continues to be strong," Pampillón says.

Macroeconomic stability as well as widespread expectations that Brazil will play a growing role in the new global economy is turning the country into a very attractive destination for foreign investors.



that are appropriate for the country. The current approach has eliminated the nightmare of inflation while maintaining the health of the country's external accounts. It began after the turbulence of 1998, when the economy faced serious problems because of its fiscal and external deficits. The situation worsened in January 1999 when Brazil became very vulnerable to international turbulence. The country's gradual adjustment policy became unsustainable, forcing Brazil to turn to a free float policy. This led to a major devaluation in the Brazilian country, which led to the collapse of the Real Plan, in which the exchange rate of the Brazilian currency served as an anchor for internal prices. The instability persisted until March because of fears that the government could not face its public debt commitments. In addition, there was concern that the Central Bank lacked resources for containing the climb of the dollar. "Brazil has managed to recover the confidence that it lost.

policies have enabled it to control inflation, now between 3% and 4%. As a result, interest rates are trending downward. Economists anticipate that rates will drop to 9.5% by 2009 from their current level of 12%. "Brazil is a country where you have to be," says Pampillón. For his part, Martínez-Lázaro notes that Brazil "has gone from being a country of the future to becoming a country of the present."

Macroeconomic stability as well as widespread expectations that Brazil will play a growing role in the new global economy are turning the country into a very attractive destination for foreign investors. "There is a surplus in the trade balance, in exports," notes Pampillón. The same thing is happening in the stock market where there has been a "spectacular jump," he adds.

Barely four years ago, the largest Latin American stock markets were on the black list of investors in emerging

Currently Brazil has an annual inflation rate of 3% and interest rates of 12.5%. Data show that there is interest in lowering the price of money. "From 1980 until 2005, the Brazilian economy grew at rates of 2.8%, 2.9% and 2.3%. It never went above 3%. In 2006, it broke that barrier, reaching 3.7%. In 2007, it has reached 4.4%." For Pampillón, these figures demonstrate that Brazil is a country for the long haul. "Everything is welcome; you see it wherever you look," he says. "Most of its problems are now on the way to being solved," adds Martínez-Lázaro.

### The Spanish Presence

Over the last 10 years, Spanish investment has played a major role in Spain's economic relations with Brazil. The total volume of Spain's investments exceeds 30 billion euros, making Spain the second-largest foreign investor (in Brazil) after the United States. Among member-states of the European Union, Spain is the country that interests Brazil

the most because Brazil leads the way in Latin American economic development, ranking third in the hemisphere and 11th in the world in 2006.

Because Brazil is an emerging economy, there are many sectors where investors can make the most of the gold mine contained in Brazil's economic development. Martínez-Lázaro encourages Spanish companies that have a great deal to teach Brazil. He advises them to take advantage of the opportunities offered by Brazil with its population of 180 million. Martínez-Lázaro lists the following attractive sectors: "The financial sector, telecommunications, tourism, construction, residential real estate, clean energy and exports of agricultural products .... Spain has a great deal to teach in those sectors." He also emphasizes the management of infrastructure and educational services. "At the moment, Brazil is making Spanish its second official language. That provides an open door for our tourism sector to take advantage of," Martínez-Lázaro notes.

Although the big Spanish multinationals already have a footprint in Brazil, the Spanish government wants to strengthen their presence in the infrastructure and service sectors by helping small and midsize Spanish companies move into Brazil and expand their role. "The problem that I see is that if you don't have enough financial resources and your managers are not well trained, they [the Spanish government] won't push you to globalize because they are afraid of failure," notes Martínez-Lázaro. However, little by little, the culture of globalization is catching on

in the mindset of (Spanish) business executives. Ultimately, "companies will have to take that approach."

The worst fear of many analysts is that Lula will not continue with the reforms already on the drawing boards. "In addition, it is a corrupt country where there is a lot of pressure from [high] taxes," says Pampillón. Nevertheless, now "is the time to awaken Brazil," he adds. All indicators point to Latin America as a region that will receive a deluge of capital from investors.

### Tourism Destination

Spain and Portugal have derived already significant benefits from their investments in Brazil. Per capita income in both those countries is growing and they have the skills they need to continue increasing their exports. Their presence in Brazil acts as "a stimulus for increasing competitiveness and efficiency and making Brazil more dynamic," says Enrique Panés, Spain's ambassador to Portugal. According to Ricardo Espírito Santo Silva, president of Brazil's Banco Espírito Santo (BES), Brazil takes in almost one hundred times more tourists than Portugal does, which means there are a great deal of opportunities in the tourism sector for Portuguese projects. Brazil's attractive economy makes it "an inevitable destination for the inflow of global investment [from Portugal]," notes Espírito Santo Silva.

Pestana is the Portuguese tourism company that has invested the most in Brazil. José Roquette, who heads Pestana, believes that it is easy to try your luck investing in Brazil "because of

the low entry costs and labor flexibility. In addition, foreign countries are exporting their business models and Brazil is importing new approaches to business." Nevertheless, Roquette warns of the country's complex tax regime and high tax rates. He says that factor can become a "disincentive for investment." In addition, he notes a serious problem in "air transportation and in the country's security and its image." For all that, Roquette encourages European investors to pursue new opportunities on the other side of the Atlantic. He believes Brazil "forces you to think big." He also stresses the delicate balance involved in Brazil's efforts to maintain growth while managing its risks.

Miguel Stilwell, director of analysis at Energias de Portugal (EDP), a company that serves the electricity sector, believes that business in Brazil is progressing at a better pace than anticipated. In 2003, EDP reorganized its business in Brazil, limiting itself to a strategy that stresses growth above all. Currently, EDP has a presence in four Brazilian states, where it deals with more than three million customers. This year, EDP is opening a dam in Maranhão in northeast Brazil. The company is committed to pursuing other new projects, always with local partners. In Brazil, electricity is a sector "that provides a good return and it is well regulated. Several companies participate," he notes.

Brazil clearly has an enormous potential to attract investors. Panés, Spain's ambassador to Portugal, encourages business executives to take advantage of those opportunities. 



*Finance Minister P. Chidambaram:*

## “India Will Be an Economic Power, and Nothing Will Stop Us”

P. Chidambaram, who as India’s finance minister is part of what is known as the economic dream team in the world’s second largest nation, sounded confident as he spoke about his nation’s surging economy, currently growing at more than 9% annually.

Chidambaram—currently serving in the ruling government of Indian Prime Minister Manmohan Singh—also predicted that rapid growth won’t last if the gains are not shared by hundreds of millions of Indians still mired in isolated, poverty-stricken villages. “If I grow at 9%, it means nothing to somebody in a village who has no access to clean drinking

water, who doesn’t have sanitation, when there is no school in a radius of 5 to 10 kilometers, with no access to basic medical care, no electricity and no roads,” said Chidambaram, kicking off the 2007-08 Wharton Leadership Lecture Series. “Nine percent growth is completely meaningless.”

But if pulling up several hundred million citizens from deep poverty—in a nation of roughly one billion people—sounds like a daunting problem, Chidambaram believes the framework does indeed exist for the poor to share in India’s current boom. The keys, he said, are better schooling and improved local infrastructure—something

that is much more possible today than ever because of the country’s soaring economy.

“The 9% growth gives me an opportunity to make life a little more meaningful for them,” Chidambaram said. “The 9% growth gives me the revenue volume to allocate more money for health education; it gives me room to involve private and public sector players, to provide the growth and the liquidity....”

### **Learning from the Mistakes of Others**

Chidambaram offered a broad overview of a rapidly developing nation that has

become a global powerhouse over the last 15 years. In addition to highlighting the success of Indian entrepreneurs in a liberalized economy, he brushed off the concerns that come with rapid growth. He insisted that India has learned from the mistakes of other rapidly-developing economies and has also benefited from unique factors, including its growing population.

“For the next 20 years, India will be an economic power, and nothing will stop us,” Chidambaram stated, after noting that India will be alone among large countries in boasting of a working-age population—compared to a population of dependents—that will continue to grow for another generation, until roughly 2040. The resulting gains in jobs, income and investment should guarantee a steady cycle of growth “as long as we don’t do anything stupid.”

more than a decade in pushing through the government reforms that have helped spur economic growth. The 62-year-old lawyer from India’s Tamil Nadu state rose in prominence along with Prime Minister Rajiv Gandhi, whose economic policies turned the country away from its brand of socialism and toward a free market economy before his assassination in 1991.

Chidambaram has served twice as India’s finance minister during the era of free-market reforms. The first time was from 1994 to 1996, when he was widely praised for curbing government spending and carrying out tax reforms in a nation where, even today, just 3.5% of the population actually pays taxes. He survived various shifts in India’s often rough-and-tumble parliamentary-style politics to regain the key job a second time, in 2004.

model would make way for an open and competitive economy,” Chidambaram said. Those reforms, he added, allowed Indian companies to compete on a global stage, and today the country’s growing array of software and biotechnology companies has even been acquiring foreign rivals. About 32% of India’s foreign investment is in the United States, he said.

One guiding principle in Chidambaram’s political career has been his belief that economic freedom and competition, rather than aggressive state controls, is what will lift the lower classes in a developing nation out of poverty. He acknowledged that the heavily rural nature of India—with some 60% of its land devoted to mostly small farms that depend on monsoons for irrigation—poses special challenges to sharing the rewards of economic growth. “There is no

Chidambaram believes the framework does indeed exist for the poor to share in India’s current boom. “I’m worried about a number of things, but I’m not worried about sustaining growth.”



For much of the 1990s and the current decade, India has had a succession of economic successes. The recent surge in gross national product—measured at 9.4% in 2006-2007—makes India the world’s second-fastest growing economy behind China, and the current projections remain rosy. Goldman Sachs recently estimated that while the Indian economy is now the world’s 12th largest, the South Asian giant should be number three behind China and the United States by 2035. Growth has been fueled by a growing urban middle-class—largely English-speaking—which has given rise to the well-documented growth in back-office operations, such as call centers, for multinational corporations.

Chidambaram (the “P” stands for “Palaniappan”) has been a key player for

If there was anyone in the audience who did not realize the significance of the economic liberalization that began in 1991, Chidambaram carefully retraced that history. He noted that Indian entrepreneurs were restrained by colonialism prior to India’s liberation in 1947, although he pointed out the irony that homegrown Tata Steel, once subjugated to mighty British Steel, bought the former UK powerhouse earlier this year. However, Chidambaram said post-1947 socialism—especially a rigid licensing regime—held back the economy before Rajiv Gandhi took power.

“In the space of six weeks, exports and imports were largely made free, exchange controls were relaxed and licensing was virtually abolished, and Indian businesses were put on notice that the socialist

organized production of goods and services in villages—only what you can consume locally,” Chidambaram said. “There is no market beyond a few kilometers.” Villagers not directly involved in farming tend to make handicrafts or work on hand looms, and many are forced to search for other work during non-growing seasons to pay for the goods that they need.

But Chidambaram believes that the rural economy can advance on several fronts. He said that the prices paid to farmers for their crops have lagged behind other costs in India, and that needs to change. He also stressed that the Indian government—which has seen tax revenues increase by a whopping 40% in just the current fiscal year—needs to reinvest much of that windfall in rural

infrastructure for drinking water and sanitation, and better schools and healthcare. But most important, he said, is training that will, in Chidambaram's words, "wean" some of India's rural population away from agriculture and into more productive manufacturing jobs, a change that would have a vast "ripple effect" on the overall economy.

### A Shortage of Knowledge Workers

Yet Chidambaram also acknowledged that India's rapid growth is starting to create some problems at the top end of the nation's economy—a shortage of workers in the most advanced professions, such as engineering, medicine and science. Currently, just 11% of India's college-age population is enrolled in higher education, which lags behind both developed and some developing nations. The government is pushing to increase that to 15% in the short term. "That is the biggest problem in India. We have enough of these shortages already showing up in the economy," he said, noting that the government is hoping to tackle this by sharply expanding the numbers of universities and by encouraging private, for-profit higher education, which doesn't yet exist in India.

It's just one area where the Indian government is seeking to promote privatization, but Chidambaram was careful to note that the current policy of undoing the remnants of Indian socialism

has proceeded on a case-by-case basis. While competition has been brought into a range of businesses, from airlines to FM radio, some state-owned industries that are successful and well-run have been kept intact. Privatization, he said, "is not an ideology."

The finance minister repeatedly stressed that the need for widespread political support in a democratically elected government sometimes makes it more difficult to implement some reforms quickly. He noted that the voting power of millions of owners of mom-and-pop store owners has so far thwarted any effort by international retailers, such as Wal-Mart, to enter the vast Indian market. "There is general fear among shopkeepers—family-run shop people are employers—that their jobs are at stake and businesses will close" if large foreign retailers enter India, Chidambaram said, although he believes that growing Indian-owned retail chains will eventually change the public's opinion on foreign investment.

Despite that impasse on allowing in U.S.-owned retail giants, Chidambaram was largely upbeat about relations between India and the United States. In particular, he voiced his support for the agreement announced in July 2005 to end the long American ban on nuclear trading with India—dating back to India's initial nuclear tests in 1974—and to provide energy and satellite aid. Chidambaram said the nuclear ban had made it very difficult for India to maintain—let alone

expand—its use of nuclear energy, which now accounts for just 3% of electricity there.

"We are friendly countries with friendly relations, although there are some differences," Chidambaram said. The main reason for that friendship is an obvious one—the increasing economic interrelations between the two nations. The rising population of Indian expatriates in the U.S.—roughly 3 million and growing—and television have also narrowed the divide.

Despite his outward confidence, Chidambaram acknowledged that he has worries, particularly about events that are well outside of his control. His list of potential problems includes a sharp rise in crude oil or commodity prices, a recession in the United States and Europe, the "sub-prime mortgage problem" and what he called "bellicose speeches" in the United Nations.

"Yes, I'm worried about a number of things, but I'm not worried about sustaining the growth," Chidambaram said. He insisted that India has closely studied the rise of other developing Asian nations—like Korea and Indonesia—in an effort to avoid mistakes and to sustain steady economic development at an even pace. "India is not immune to the laws of physics," he added. "India is not immune to the laws of thermodynamics, and India cannot be immune to the laws of economics." 