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The Fiscal Policy to Attract Investments to the State of Pernambuco – Socioeconomic Impacts

José da Cruz Lima Júnior

Advisor: Professor Reid Click

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Introduction

The neoliberal industrial policy adopted by capitalist countries reflected in peripheral countries from the early 1980s, at which time these countries, including Brazil, adopted the new model of industrial policy. This presented to investors, the existence of a new variable - the granting of fiscal and financial incentives - in the field of locational choice.

Given this new variable, and given the global conformation of globalization, where the world is becoming closer and faster information flows, companies tend to settle in places that offer greater competitive conditions. As a result, the fiscal and financial incentives provided by governments have become a differential for decision making for the entrepreneur, as to where to invest.

In Brazil, especially from 1994, units of the Federation, aware of this new variable, started to offer individually, their own competitive advantages by establishing financial and tax incentive schemes, using the main state tax, the Tax Operations Relating to The Goods and Services (ICMS). This occurred as a result of inadequate or sometimes even nonexistent national development policies to deal with deep regional inequalities.

As a result of this investment attraction by each State, there has been a fierce tax competition among the federating units, known as "fiscal war". This phenomenon nowadays has reached such a high level that all states without exception have demanded changes in the tax structure in the main state tax.

Because the ICMS is a tax with a high base, further expanded by the 1988 Constitution, it has allowed States to use as tools for their investment attraction policy, various fiscal and financial instruments, such as the deferral, the reduction of calculation base, the presumed credit and financial credit, with direct and indirect consequences on tax collection.

This has triggered a process of non-compliance with various provisions laid down in the federal constitution of 1988, the tax laws, especially state laws, and the Fiscal Responsibility Law (FRL), in the frantic search for investments.

With regard to the attraction of investments policies adopted by the state government of Pernambuco, it closely relate to the Keynesian perspective, since it relies on state intervention to achieve development in the region. To attract investment, Pernambuco is using a series of measures ranging from granting specific benefits to companies that settle in the state, as well as offering tax cuts, promoting works that help companies with logistics, especially transportation infrastructure.

This has caused significant advances in the Pernambuco economy in recent years, with an increased economic turnover in the state.

Public and private investments which are being advertised frequently, mostly from the year 2007 aroused the interest of the market, motivated by the increased movement of capital in the economy. Likewise, a large number of news stories on the recent growth of Pernambuco, both in the media and in political speeches. Preliminary data from the Brazilian Institute of Geography and Statistics (IBGE) for the year 2012 rates Pernambuco as the tenth largest economy in the country, according to the data of Gross Domestic Product (GDP) of the Brazilian states (IBGE, 2013). The state became a unifying agent of investments in Brazil. Many hatch evidence to justify the current performance, and many point to the change that is occurring in the industrial profile of the state. Industries that did not exist previously, such as oil, gas, offshore and marine, are being implemented in the state greatly boosting supply chains in the region. Thus, the gains go beyond the installation of these large companies, especially in the development of whole production chains which originate from these driving activities.

Apart from industrial output, other activities are being developed in the state, especially in the sectors of trade, services, construction, education and technology. In addition, major infrastructure projects are being implemented in the state, highlighting the improvement in port and transport infrastructure. Regarding the changes in port infrastructure in the state, the port complex of SUAPE is the highlight, with new investments underway to expand its cargo handling capacity and improve the existing structure. Many companies which are installed in the SUAPE port complex will benefit directly, as well as those

that use the port as a production flow channel, but do not have production plants within the complex. Although the SUAPE port complex represents an aggregation center for investments, the government is working to diversify the location of the plants. For this reason, the Development Program of Pernambuco (PRODEPE) and other specific programs for certain sectors offer different incentives that encourage the installation of companies outside the Recife Metropolitan Region (RMR), like SUAPE. Generally speaking, the idea is that government action is critical to the greater spatial balance of productive activity. Therefore, this research seeks to determine through the observation of indicators of socioeconomic development, how the performance of the state government of Pernambuco, with regard to tax incentives, impacted in the recent development of the state.

This process sparked interest in understanding the causes that led states and, in particular, the state of Pernambuco, to take part so fiercely in this competition to attract investment. It was established from here, the need to develop an analysis of the historical process of economic and institutional development of the Brazilian political system, and the debate about the fiscal federalism, seeking to identify and correlate this competitive process with the economic development policies that were adopted in the period that has elapsed since its origin to the present day, in such an unsystematic and punctual manner.

To this end, the study will consider the period from 2007 to 2012 (or 2013 whenever possible to get the data for this year), in which will be appreciated the policies adopted for development and will also identify the characteristics and the main tax instruments used in the industrial policy of the state government of Pernambuco in order to attract investment. The economic effects and social impacts will be measured by the socioeconomic indicators available. So the work to be presented is intended to cover part of a gap on the subject, and also awaken the leaders of the institutions to the importance of keeping data records in order to be able to contribute to further scientific production, capable of effectively measuring social and economic effects of the tax incentive programs granted, in the context of a real national “auction”, in the welfare of the Brazilian society, especially of Pernambuco.

This paper will define as its territorial framework of the analysis the State of Pernambuco as the holder of the infrastructure able to offer comparative advantages, which added to tax and financial benefits offered by the state government, especially from the mid -1990s, were sufficient to attract investors, who moved to this State.

Through direct access to the Brazilian Institute of Geography and Statistics (IBGE), the State Bureau of Planning and Research - CONDEPE/FIDEM Pernambuco, Institute of Applied Economic Research (IPEA) sites, the Treasury of the State of Pernambuco (PE - SEFAZ) and the Secretariat of Federal Revenue (SRF), relevant data used in this work include Gross Domestic Product (GDP), Human Development Index (HDI), taxes and product export value, aiming at achieving the specific objectives of this paper.

For a better understanding of these results, tables and graphs from quantitative data will be prepared to illustrate:

- a) total number of establishments involved;
- b) quantity of projects approved;
- c) unemployment variation;
- d) exportation and importation variation;
- e) collection of ICMS in municipalities in the programs;
- f) Municipalities Participation Index (IPM) related to these cities;
- g) evolution of the ICMS levied by the State;
- h) HDI – Human Development Index variation.

From the data obtained, we wish to compare the state tax exempt and the actually generated by the companies established in Pernambuco, the number of settled facilities, and the volume of investment, and behaviors of GDP, IPM and IDH, over the considered period.

In this way, the paper will attempt to investigate whether there was, in fact, a significant growth of economic activities in the State of Pernambuco and,

consequently, an higher performance when compared to the States of Bahia and Ceará, as well as to the Brazil as a whole, and a greater relative share of Pernambuco GDP in the Brazilian GDP, or whether the desired objectives have not been achieved, highlighting the need for improvement of such mechanisms for the attraction of investments.

1 - Fiscal war and Federalism

1.1 The Debate on Fiscal Federalism

The aim of this chapter is not to provide more in-depth discussion of fiscal federalism, since such a debate lies beyond the scope of this work. The study will thus be limited to presenting the kernel of such discussions, as they are being conducted by scholars and academics in terms of the link between the issue of federalism and theoretical economic proposals.

First, it is worth noting that, for Prado (2006), federations are established in a geographical space based the historical, social, religious constitution of a human grouping. In contradistinction to unitary systems (with a single budget, planning and coordination centralized in a single bureaucracy), federations are adopted for four main reasons: geographical (countries of continental scope are resistant to unification); political (to enjoy the advantages of union without losing regional identity, from a cultural, religious, historical and ethnic point of view); economic (to increase the efficiency of provision of public goods); and historical (colonization and the formation of national states) (PRADO, 2006).

According to Moraes (2001), federalism can be understood in three ways: a) in strictly economic terms, according to which the state is divided into different levels of government (allocation and distribution of resources, stabilization of the economy) on the basis of “criteria of economic efficiency”; b) politically, in terms of the decentralization of political practice (from a unitary state to federated states), it may be seen as providing a deeper form of democracy; and c) in broader terms, federalism may be a “doctrine of a global nature”, such as liberalism or socialism.

Brazil, a federative republic, has three distinct levels of government: a) the Union (Federal Government), sub-national governments SNGs (States and the Federal District) and local governments (municipalities). The Brazilian federative pact is, furthermore, one of the fixed fundamental clauses of the country’s current constitution. Brazilian federalism underwent significant changes to its model after the 1988 Constitution, since criticisms of the

centralization of federal government power, as promoted by the military regime, led to a clamor for decentralization in the form of extending the tax-collecting rights of States and municipalities (REZENDE, 2003).

Thus, the debate regarding fiscal federalism in Brazil rests on three fundamental pillars: 1. the question of the fiscal structure of federations (attribution of powers, responsibilities and autonomy, transfers between levels of government, permission to collect taxes, improvement of intergovernmental relations); 2. the proposal of normative models regarding the most efficient federative system; 3. and the link between fiscal federalism and (State and national) development policies.

1.2. Federalism and Fiscal Competition

This brief overview of fiscal federalism enables us to focus on one of its most significant manifestations in contemporary Brazil: fiscal competition. First, however, we must define this concept. Fiscal competition, commonly called “fiscal war”, is a situation in which federated entities compete for private investment in their territory, attracting investment by way of fiscal mechanisms, such as exemption from the ICMS value-added tax, extension of deadlines for payment of tax, presumed credit, and others.

“Fiscal war” is waged without complying with Complementary Law nº 24/75, which forbids the granting of exemptions and other incentives relating to the ICMS, except when these are envisaged in contracts drawn up in the course of meetings with the Treasury Policy Council (Confaz), which brings together representatives of all the States and the Federal District.

“Fiscal war,” as the name suggests, is a situation of conflict within the Federation. The federated entity gains—when, in fact, it imposes in most cases, a loss on one or some of the others, since war is rarely a positive sum game. Federalism, which is a cooperative relation between government units is undermined.

Various authors and scholars of the subject understand that “fiscal war” has become fiercer in recent decades, owing to the absence of regional

development policies on the part of the federal government. They argue that the federated units, faced with a federal government that has abandoned regional development policies, have taken upon themselves the responsibility for generating employment and economic growth for their citizens and bringing development to their territories. The mechanism for promoting such development is usually fiscal advantages. To sum up, “fiscal war” would seem to be “a peculiar form of regional development policy” (PRADO, 2005, p. 6), the “most obvious expression of autonomy of the development policies of the various States” (FERREIRA, 2005, p. 13).

In other words, a tax at the State level, over whose principal variables (such the tax base and rates, for example) the Federal Government and Senate exercise no control would appear to create a “potential for distortion”, which tends to use taxation as an instrument of regional economic policy to the detriment of pure revenue generation. Such destructive potential may have been responsible for the escalation of the “fiscal war” in Brazil (PRADO, 2003). In fact, according to Rezende(2003, p. 29),

“...the virtual abandonment, by the federal government, of policies related to the less economically developed regions stalled the reduction in income disparities between the North and Northeast and South and Southeast regions, in the mid-1980s, increasing the difficulties States located in poorer regions experienced in sustaining their policies relating to meeting social needs.”

In other words, the States seem to have waged “fiscal war” as a way of filling the gap left by federal government omission (the absence of regulation of national development policies), a situation that would appear to produce “the most perverse of systems” (PRADO, 2005). This, VARSANO (1997, p. 5) argues, is because the federated states take on the responsibility for promoting development and conduct this by way of “fiscal war”, with disastrous results, since the winners of fiscal wars are, usually, States with greater economic power, who come to be the most developed, with the biggest markets and the best infrastructure. By forgoing revenue generation, the state is also neglecting the provision of services (health, education, infrastructure and so forth) which

are necessary for production and sacrificing fiscal equilibrium, thereby generating macro-economic instability.

“Fiscal war” would thus seem to be a kind of subordination of some instruments of political development to a competitive logic. In other words, it is a peculiar situation resulting from a dynamic of competition between governments through the use of tax and budget instruments. However, it should be made clear that the problem of “fiscal war” derives not from State development policies, but from the perverse character and unbridled competitiveness they assume for determined periods.

In fact, Prado (2005a) warns that, according to data from the automobile industry, the main mechanism used in “fiscal war” is the ICMS (other mechanisms, such donation of land, government spending on infrastructure and others are not the dominant ones). As a kind of tax on value-added sales tax levied on company revenues, the benefits are granted through a reduction of the outstanding balance. Thus, fiscal incentives involving deferral of payment and extension of deadlines vis-à-vis the ICMS tax, normally with low interest rates and adjustments for inflation, represent a cost for the State. At a time when the Brazilian economy is stable, the impact is not so great; however, if inflation were high, such benefits would appear to be what is called a “true gift”.

Private companies therefore preside over an “auction” among States, in which, notwithstanding detailed studies of location that consider different possible destinations for their financial investment—where the issue of fiscal incentives is only one of the factors, and normally one of the least important—they end up stoking a “fiscal war” to obtain the greatest possible economic-financial advantage. This auction would appear only to be possible because of the disconnected nature of the States, which can thus be easily be manipulated by companies. It is thus argued that the perverse “fiscal war” in contemporary Brazil is a process that is entirely controlled by private companies.

It is important to point out that “fiscal war” is understood to be something deleterious only when it is excessively competitive, i.e. there is no regulation beyond State level. This provides stronger grounds for the argument that the State should grant (tax and budgetary) benefits to private companies for the

purpose of promoting development and for the ultimate good of the community. In such “healthy fiscal competition”, the idea is that efficient fiscal competition would be of benefit to citizens.

1.3 Fiscal Competition in Brazil as Autonomous Development Policy

As has been noted, the issue of fiscal competition is addressed in terms of Brazilian federalism, as something intimately linked to regional development policies. “Fiscal war” is believed to be a response on the part of the States to the absence of such policies at national level (under the auspices of the central government) and has thus become a necessary activity for each State to promote its own economic development.

As a consequence, the economic theory of fiscal federalism argues that States wage “fiscal war” because they need to take action to protect the interests of their people, to eliminate poverty, unemployment and inequality. In other words, “fiscal war” would appear to be a tool that the States of the Federation have recourse to compensate for the absence of a national or regional development plan.

According to the science of economics, fiscal subsidies are restrictions on the functioning of markets and should be eliminated; a generalized subsidies policy (“fiscal war”) would appear therefore to be questionable. Varsano (1997) argues that fiscal incentives should be conceded in cases where the private investment would not be made without the benefit or where benefits result in new productive units (additional investment) or even in cases where the benefits of the incentive are appropriated by the residents who are losing out, because of cuts in the provision of public goods (due to the concession). It can thus be seen that there are serious questions regarding the efficiency of such concessions. The same questions are raised by Prado (2005), who argues that the States always promote regional development programs by way of tax incentives and that “fiscal war” is merely a savagely competitive form of this policy. Ferreira (2005, p. 18) likewise comes to the conclusion that tax and budgetary incentives are “intrinsically inefficient and problematical” and that autonomous development policies (fiscal competition) should not rule out

development policies that are centrally-structured, i.e. run by the current central government.

As we have seen, the argument defended here is that this is a process that is not per se malevolent, but which requires control by a central government to establish a “healthy fiscal war”. Such control is necessary to ensure the (healthy) fiscal competition between Brazilian States forms part of a broader context of national development policy.

The idea that the effectiveness of regional development policies as a mechanism capable of bringing democracy, equality and social justice is defended by the prevailing theory of economics (represented principally by the fields of Public Sector Economics and Regional Urban Economics). Having accepted that the relation between “fiscal war” and development is pertinent and genuine, it may therefore be possible to list some positive and some negative aspects of the phenomenon of fiscal competition in Brazil.

According to Varsano (1997), from the point of view of State governments, the federated unit accumulates gains, albeit temporary ones, by waging “fiscal war”, since it is the official responsibility of the State Governor to defend the interests of his or her State as a matter of priority in relation to the overall interests of the nation and, in cases where interests conflict, to defend those of his own State, on the grounds of the autonomy of federated units.

This raises an issue that should be highlighted: the autonomy of the States. As a result of this, the practice of “fiscal war” is defended by governors and secretaries across the country on the basis of the idea that this is a manifestation of the freedom that each State has to defend its own (just) interests and to promote its own policies and strategic development actions. This is why there is a broad current of thought that sees such competitive practices [“fiscal war”] as one of the more virtuous aspects of federations. For authors who lay emphasis on so-called competitive federalism, so long as certain conditions are complied with, competition between States for investment may be a way of increasing the systemic efficiency of the local economy. In other words, from an economic point of view, some degree of conflict is

necessary to promote a competitive economy and government efficiency, for example. (FERREIRA, 2005, p.15).

It is a recurrent feature of meetings or seminars of fiscal federalism for the Treasury Secretaries of some States to claim this is not “fiscal war”, but “policies for attracting investment” or “autonomous policies for incentivizing productive activity”. Such claims, which reject the term “war” for reason of its negative connotations, show how the Brazilian States understand today’s idea of autonomy as vital and of the utmost importance in managing their internal affairs.

This is why, as noted above, theories see the problem of “fiscal war” as lying, not in its very existence, but in its exacerbation. After all, if it is a development policy, it must consequently be a powerful tool for business management and administration. However, this does not mean that any kind of “fiscal war” is a positive thing for federation. As PRADO (2005) warns, the idea of the efficiency of “fiscal war” depends on “epic and unreal” suppositions regarding factors such as the capacity of State governments to recognize the profile of companies and the weight of each variable they take into account in their investment decision-making process).

There is thus a need, the author continues, to set up a “higher arbitration authority” to avoid maximal fiscal costs in fiscal competition. This maximum fiscal cost occurs because of a phenomenon known in the theory of fiscal federalism as ‘the race to the bottom’.

Many authors therefore argue that fiscal competition should not be abolished (it has been around for a long time in Brazil, but only recently has taken on perverse proportions), since the problem is not fiscal competition per se, but its unbridled and perversely competitive form. Put differently, the problem is that, in the absence of an alternative form of State coordination, the process comes to be controlled by a private sector that aims to maximize its profits but not the public benefits of the use of fiscal resources. In the end, it may not be desirable, because of the various advantages provided by ordered federal autonomy (PRADO, 2005, p. 33).

Like the autonomy of States, one argument in favor of “fiscal war” claims that, as it is a policy to encourage private businesses, it also generates employment and hence provides additional income for the residents of the State, which, as VARSANO (1997) puts it, is, from an economic point of view “good business” for the State that grants the concession.

After all, it is supposed that additional income will translate into greater consumption in the State, meaning greater circulation of goods and higher ICMS revenue. The incentive is thus deemed to serve as a “springboard” of a chain reaction that results—incredibly—in an increase in revenue, as shown by C. Maranhão in study research to the Finance Secretariat.

Clearly, when competition occurs between States with relatively similar degrees of development, tax benefits may make a difference, since they provide similar systemic advantages: one State will not have to cover possible differences in competitiveness arising from its level of development and, as a consequence, States end up ensuring that, in the course of the competitive process, there is growing use of tax instruments. This is one aspect of leveling: assuming that States have the same economic capacity, each State tends to offer what the other does. It can thus be concluded that existence of legally equal State governments competing for investment often leads to a constant mutual cancelling out of benefits, or “race to the bottom”.

However, it is worth pointing out that another negative aspect of “fiscal war”, which is closely related to the issue of perverse competition, is the phenomenon of redundancy. According to FERREIRA (2005, p. 19), redundancy is the “product of a situation in which the State government concedes tax and/or budgetary benefits to companies who may invest in some way in the State even without these benefits”.

In the absence of a central government sponsored coordinated economic development policy it is easy to see that redundancy is highly likely to occur, whenever one or more States initiates a “fiscal war”, or as some would prefer to put it, a process of attracting investment.

In such a situation, the main winners of a “fiscal war” are the private companies, who receive ever increasing fiscal benefits, leading them to conduct the aforementioned “auction” among the States who are eager for them to invest.

Fiscal competition, as it is understood here, is what SHAH (2001) calls “inter-jurisdictional competition”. According to this scholar, fiscal competition may foster efficiency in a federal economy, primarily as a result of the following factors: adjustment of public services to the preferences of citizens, reinforcement of government responsibility, reduction of the influence of corruption, and improved quality, quantity and access to local public services.

As “fiscal war” fosters competition between federated units for investment, there is supposedly a process of innovation of the provision of public services. This idea is founded on so-called “competitive federalism”, in which the higher degree of decentralization is deemed to make the public sector more responsible and receptive to the wishes of its citizens. As SHAH (2001) puts it, “this difference in local public services policy can be seen as a desirable break with uniform nationwide practices”.

Fiscal competition is also deemed to have the advantage of making public administration more responsible, in so far as governments seek better practices. Focus shifts to the results and governments adopt benchmarks for more attractive and competitive services.

Likewise, as there is supposedly no monopoly (due to competitive pressure from other federated units), a climate of fiscal competition between States is deemed to favor the disappearance or reduction of inefficiencies and personal advantage-taking, since the competitive process entails greater access to information and an end to regulatory barriers.

However, SHAH (2001) also lists some of the adverse consequences of inter-jurisdictional competition, which lead this author to call it “do-it-yourself federalism”. These include a weakening of the common market, a decline in quality of life, insufficient provision of rewards for merit and adverse social

policy, as well as predatory competition among jurisdictions to provide more attractive tax incentives.

Fiscal competition could have the disadvantage of weakening the common market, as subnational governments, in their quest to attract qualified labor and capital, may favor “beggar thy neighbor” style policies. This would thus provide a source of inefficiency as federated units use their spending and regulatory powers to improve local conditions at the expense of non-residents. Here again we have the idea of a State government that primarily looks after its own State’s interests to the detriment of those of the country as a whole, adopting “beggar my neighbor” policies to attract economic activity from other States.

This leads to another deleterious aspect of fiscal competition: a decline in quality of life. Since States, in an effort to attract labor and capital, make increasing use of tax and budgetary benefits, they compromise their sources of revenue and hence the provision of public services. The aforementioned “*race to the bottom*” occasions what SHAH (2001) calls “a descending spiral of public sector activities”. This also impacts the minimum level of quality of services, as it is harder to attain a minimum quality standard when the level of benefits conceded exceeds appropriate limits.

1.4 Concluding Remarks on the Federation Debate

Brazil is a federative republic and its national territory is thus divided into various subnational political-administrative units, whose autonomy is enshrined in the 1988 Federal Constitution. One of the most decisive aspects of this constitution was the autonomy granted to the States to legislate regarding the main state-level tax, the ICMS.

This autonomy, together with growing abandonment of national regional development policies by the Brazilian central government, laid the ground for States to take responsibility for their own social and economic development, by way of independent policies based principally on the conceding fiscal (budgetary and tax) benefits.

In the context of the opening of the Brazilian market, owing to the (political and economic) pressures of globalization, fiscal competition among federated units has become ever fiercer, reaching a historic peak with the arrival in the country of giant automobile manufacturing corporations.

It has been noted, however, that one primary element needs to be borne in mind regarding fiscal competition. This is the autonomy of the States in conducting their own affairs and defending their own interests. In a federative republic that prides itself on having emerged from a long period of military dictatorship, the importance of this should not be underestimated and, as shown above, is something that State governors and secretaries vehemently defend. On the other hand, it should also be borne in mind that current economic theories have it that the absence of political and economic coordination on the part of the central government ends up producing undesirable distortions, as Brazil has experienced in recent years. Fiscal competition is therefore clearly a subject of great controversy. If, on the one hand, it bolsters a desirable autonomy of federated units, serves to generate income and employment, boosts the competitiveness of States and encourages responsible government and different kinds of innovation in the provision of public services, on the other, it fosters predatory competition, leads to a decline in the State budget for public services and quality of life, due to the adoption of “beggar thy neighbor” policies. Whether one is for or against fiscal competition, one fact remains undeniable: the way this policy has been practiced in Brazil is a phenomenon that merits in-depth study and reflection.

2 - Pernambuco Tax Incentive Programs – Legal Framework

2.1 Development Program of the State of Pernambuco - PRODEPE

The main structuring program of tax incentives offered by the state of Pernambuco is PRODEPE - Development Program of Pernambuco State, regulated by Law no. 11.675/99 and Decree n 21.959/99, which consists of the granting of presumed credit both to companies classified in priority industrial clusters and special groups as well as the ones classified in activities of strategic importance, import companies and distribution centres.

2.1.1 Priority Industrial Clusters

The projects that can fit the prime industrial clusters are exclusively those related in a specific decree, according to their characterization in the production chain, as follows: (Decree nº 22.217, of 25.04.2000).

- Agribusiness;
- Metalworking and equipment transportation;
- Electrical goods and Electronics;
- Pharmacology and personal hygiene;
- Beverages;
- Non-metallic minerals (except red tiles);
- Textiles;
- Plastics;
- Furniture.

Companies classified in the prime industrial groupings listed above, can be stimulated, in the terms contained in the Decree, by the granting of presumed ICMS credit, which shall comply with the following characteristics:

Municipality included in the Metropolitan Region: the amount to be granted is equivalent to the percentage of up to 75% of the tax value, calculated monthly during the period of benefit that can reach 12 years. (Art.5, II, Decree nº 21.959/99 value). Ten percentage points (10%) can be added, provided that the recipient firms are located in the municipalities of Abreu e Lima, Araçoiaba, Igarassu, Itamaracá, Itapissuma, Olinda, and Paulista, with investment project in the amount of at least R\$ 100,000,000 00 (one hundred million reais), and reaching an annual gross income equal to or greater than R\$ 500,000,000.00 (five hundred million reais) [Art.5, §18 of the Decree. 21.959/99];

Municipality outside the Metropolitan region: the amount to be granted is equivalent to up to 85% of the tax, for which the taxpayer is directly responsible, accounted for in each tax period (Article 5, §17, I, of Decree No 21.959/99);

Municipality located in RD “Zona da Mata”:

Art.5, §17, I, of Decree nº 21.959/99: up to 90% of the tax, under the conditions set below:

be primarily engaged in the manufacturing of food products;

have investment project values of at least R\$ 100,000,000.00 (one hundred million reais);

generate up to 300 (three hundred) direct jobs

Municipality located in the “Agreste Pernambucano”: 90% (ninety percent) of the tax;

Municipality located the “Sertão Pernambucano”: 95% of the tax (ninety five percent) [Art.5, §17, I, of the Decree nº 21.959/99].

With regards to the chain production of plastic, the percentage of the presumed credit will be reduced by 05 (five) percentage points when the processed product fit into one of the following cases: (§3, and sections I and II, inserted by Decree nº 23,188, of 10:04:01)

is not biodegradable;

Does not use as raw materials, at least 30% of recycled material.

2.1.2 Special Industries Clusters

The business developments that may fit into the special industrial clusters are solely those listed in state laws, as follows:

- Special industrial groupings, as follows (Art.5, §1, II, of Law No. 11.675/99): 95% (amount to be granted).
- Car manufacturing;
- pharmacochemical;
- steel and aluminium production
- manufacturing of flat glass, tempered or not;
- metallurgical - from July 1, 2014, (Law nº 14.505, of 07.12.2011).

The period of concession is up to 12 years, starting from the day following the publication of the granting Decree, extendable or renewable for) a period equal to the period granted, at the discretion of the Executive Branch (Article 5, III, Decree nº 21.959/99).

2.1.3 Relevant Activities

Industrial activities not included in the priority production, may be encouraged by the award of ICMS presumed credit to an extent equal to:

- 47.5% (forty -seven point five per cent) of the ICMS, for which the taxpayer is directly responsible, accounted for in each tax period in municipalities located in the Metropolitan Region (Art.7, I, "a", the Decree nº 21.959/99);
- 75% (seventy five percent), provided that the beneficiary is located in a municipality outside the Metropolitan Region of Recife (Art.7, §1, II, Decree no 21.959/99).

The period of concession up to 8 years from the day following the publication of the granting (concessional)decree and may be extended or renewed for a maximum equivalent to the same period, at the discretion of the Executive Branch (Art.7, III of the Decree nº 21.959/99).

2.1.4 Industrial Activities Which Are Not Entitled PRODEPE

No PRODEPE benefits will not be granted to the following industrial activities (Art.6, §1, of Decree nº 21.959/99).

- construction;
- extractive industries;
- sugarcane agribusiness;
- industry related to petroleum liquefied gas.

2.2 Stimulus to Wholesale Trade and Importers of Goods

Ports and airports activities can be stimulated by granting ICMS tax benefits covering the import of goods from abroad, by offering a deferral of ICMS on these operations.

In the subsequent transaction by the importer presumed credit will be limited presumed credit:

in the case of internal operations, to the following maximum percentage of the value of the operation (Art.9, II, Decree nº 21.959/99).

3,5% (three and a half percent) when the tax burden imposed is less than or equal to 7% (seven percent);

6% (six percent), when the tax rate applicable is more than 7% (seven percent) and less than or equal to 12% (twelve percent);

8% (eight percent), when applicable tax burden exceeds 12% (twelve percent) and less than or equal to 17% (seventeen percent);
10% (ten percent), when the tax rate applicable is more than 17% (seventeen percent);
in the case of interstate transactions, the value corresponding to a maximum of 47.5% (forty -seven point five percent) of the assessed tax) (Art.9, II, Decree nº 21.959/99).

The period of concession, up to 07 years counting from the day following the publication of the concessional decree and may be extended or renewed, at most, for the same period, at the discretion of the executive branch (Article 9, IV of the Decree nº 21.959/99).

2.3 Fostering Central Distribution

The Central Distribution can be stimulated by granting ICMS tax benefits, in the following percentages:

when dealing with interstate operations, estimated (presumed) credit is granted in the 3% (three percent) of the total value (Art.10, I, of Decree nº 21.959/99).

in the case of entry of goods being transferred from business located in another unit of the Federation, is granted credit in the amount of 3% (three percent) of the total value (Article 10, II, Decree no. 21,959 / 99).

The period of concession is up to fifteen (15) years from the day following the publication of the granting(concessional) month, the deadline may be, at the request of the person concerned, extended or renewed, at the most, for the same period, at the discretion of the Executive Branch (Article 10, sections III and IV of the Decree. 21.959/99).

2.4 Programs of Incentives by Sector

The tax incentive PRODINPE was created to meet a specific demand, the Atlântico Sul Shipyard, as well as being responsible for the incentive that benefits the Abreu e Lima Refinery.

From this prompting action, the shipbuilding industry in the state has expanded, and now is expecting other projects to settle in the state, such as the STX Promar and BMC Off shore Construction and Installation.

The discovery of an oil reserve in Brazil, located between the states of Espírito Santo and Santa Catarina, will boost the country's economy. The reserve is 800 km long by 200 km wide and at a depth of 5 to 6000 meters below the water surface. The discovery points to a reserve of 100 billion barrels of oil, making it one of the largest reserves in the world. The new reserve is seven times the current reserves of oil and gas owned by Petrobrás in Brazil. To this end, new ships, platforms, pipelines, refineries and petrochemical plants are going to be needed, to be built in the country. Therefore, the new shipyards to settle in Pernambuco have a good estimate of future production in order to meet the demand that will arise from the exploitation of those reserves. Thus, the state encouraged the settlement of these projects offering different incentives.

To the benefit of The Metalworking and Mechanical Engineering Industry, metalworking industry, which provides the framework for both companies, we use the tax incentive PRODEPE. Therefore, members of the shipbuilding industry and refinery also have incentives to settle in Pernambuco.

Finally, the PRODEAUTO and Port Activity Incentive Program.

The tax incentive granted by PRODEAUTO to industrial ventures consists of:

- a) Presumed credit of 95% of ICMS outstanding balance;
- b) Deferred payment of ICMS on imported resources needed for manufacturing automotive vehicles.

To the wholesale dealer of vehicles is offered:

Presumed credit equivalent to 95% of the outstanding balance of the ICMS;

Delayed payment of ICMS due on imported vehicles;

Deferral of payment of the outstanding balance of ICMS; on national vehicles.

Table 2.1 - Summary of Pernambuco Tax Incentive Programs			
Period	Program	Sector target	Incentive Characteristics
1999	PRODEPE	Industrial in general	Reduce of the debt of ICMS in 75% to 95%
2004	PRODINPE	Naval	exemption OR deferral of ICMS of inputs
2006	Development Program of the Footwear Industry, Handbags, Belts and Balls Sports State of Pernambuco	Footwear and allied industries	Reduction of ICMS with higher percentage depending on the location of the plant out of RMR
2006	Oil Refinery	Oil Refining	Reduction of ICMS
2008	PRODEAUTO	Automotive	Reduction of ICMS of 95% regardless of plant location
2009	Program to Stimulate Activity Port of Pernambuco	Activity Port	Reduction of the calculation basis of ICMS and ICMS reduction in selling (5%)

Source: Sefaz/PE

3 - The Effects of Tax Incentives in the Economy of Pernambuco

In this scenario of tax incentive program, aimed at encouraging the installation of new companies within the state, as well as ensuring the support to local industries in a productive and competitive business scenario, we are going to analyse the scope of the Development Program of the State of Pernambuco – PRODEPE, responsible for the greater range of tax benefits aimed to the industrial sector. To this end, it is necessary to assess the importance of tax benefits policies offered by the state of Pernambuco, over the six years in the analysis.

The theme of the tax benefits granted by individual states has generated a broad national discussion around the effects of the much-talked about "fiscal war". No definition of procedure can correct existing distortions between the regions of the federation due to lack of regional development policies at state level that minimizes the asymmetry of their economic and social indicators. The agenda of the debate includes not only an economic and fiscal perspective, but also a political one because it involves definitions about compensation funds, tax reforms and issues related to the current political environment that is strongly influenced by the approaching elections.

The national debate originated the filing of several lawsuits involving discussions of the subject, which are currently under judgement in the Supreme Court requesting the publication of a legal Precedent, declaring the unconstitutionality of the tax benefits granted by individual States. There is no doubt that the use of tax relief policies by the less developed states - generating the so called fiscal war – were required to keep and or improve the number of businesses, especially, by attracting more new industries to their territories, providing them with incentives that allow them to reduce the payment of ICMS and to trade more competitively than their competitors, both nationally and globally.

The legal actions started by those who feel disadvantaged (mainly Sao Paulo State) contain allegations that the administrative rite imposed by the grantor states with reference to tax benefits does not meet the prerogatives of the National Council of Fiscal Policy - CONFAZ, which bind the granting of incentives to the unanimous approval of the states represented in CONFAZ.

Due to a strong economic asymmetry between the North and Northeast and the other Brazilian regions, with the consequent wide differences in economic and social indicators, this unanimity required by CONFAZ, of course, has never been achieved, given the conflicting interests among the most developed regions and the less favored.

As noted above, the absence of a national policy defining the guidelines for regional development, aimed at minimizing the differences between the regions has acted as a shelter in favour of the granting of tax benefits as a way to strengthen the economic development of the state and provide a decent social environment for its citizens.

It is well known that the publication of a legal Precedent by the Supreme Court, endorsing the claims of unconstitutionality, have serious implications to the national economy, creating a climate of legal instability which would reflect on the economic environment, as the enterprises that enjoyed tax benefits would face having to return the funds granted by states. This crucial fact has contributed to the lack of a consensual solution for the matter, allowing the debate to continue, attempting to find terms of agreement outside the legal environment in order to accommodate the conflicting interests of states.

To this end, discussions for a possible exit from this fiscal and legal entanglement are taking place in the Congress, specifically the Senate, involving the Federal Government and the federated entities, even seeking the creation of an appropriate tax reform able to meet the current tax demands.

Within this national debate, several proposals are being presented in favour of the validation of the tax benefits already granted by the States and the adoption of a new regulatory framework to govern tax incentives. It is also being suggested the creation of Compensatory Funds (through the Federal

Government) to compensate possible losses in ICMS collection suffered by the States and, finally, the changes in the levels of ICMS interstate rates between different regions of the Federation, giving a greater taxation burden to the state of destination.

Owing to the complexity of the agenda in discussion, taking into account the different economic and fiscal characteristics of each state involved and the numerous conflicting interests, so far, no solution that meets the aspirations of each state of the Federation has been achieved.

Turning back to the scope of this study - to highlight the importance of granting tax benefits to the economy of Pernambuco – we state that the capture of hundreds of new businesses to join the industrial park of the state, as well as the keeping and expansion of industrial projects already installed in Pernambuco, through the adoption of a consistent policy of fiscal incentives has contributed greatly to the solid socioeconomic development experienced in recent years by the state, with significant gains in quality of life for the people of Pernambuco.

It is also worth mentioning the direct and indirect effects of the implementation of this fiscal stimulus policy carried out by Pernambuco, thus enabling the provision of funds from the state treasury to the implementation of public policies that ensure the necessary infrastructure for the expansion of its economy. We can identify four main points of impact on ICMS collection that occur when a new industrial development settles in the state:

- a) Firstly, we consider the direct ICMS to be collected from the new enterprise: if the installation did not take place in Pernambuco, this ICMS, however reduced, would not contribute to the State Treasury, as in fact, it would not exist;
- b) Secondly, we have to take into account the power/gas effect, which refers to new purchases made by the new business from Pernambuco power and gas suppliers: indirectly, their purchase will contribute to increasing ICMS revenue from these energy supplies providers;

- c) Thirdly, we emphasize domestic acquisitions made by the new industry. While settling in the state territory, the businesses tends not only to preserve their strategic suppliers regardless of location, but also to seek local partners which can ensure competitive gains in production, by supply of raw materials and capital goods, at advantageous prices and with more efficient deliveries. According the data presented by the industrial sector, 43% of all purchases by local industries, in 2012, were made here in Pernambuco. Thus, we ought to take into account the indirect ICMS generated by local suppliers in their sales to the newly settled business;
- d) Finally, but associated with the greatest social impact, we must consider the effects generated by the extra income, derived from the creation of jobs by the new enterprises that came to settle in Pernambuco. Based on the Household Budget Survey (POF/IBGE), 2008 to 2009, it is possible to identify the different types of consumer spending and what percentage of them are subject to ICMS taxation, considering the average wage of a new employee. If an average rate is assigned, based on the majority of taxed goods and a level of remuneration is set consistently with the Pernambuco industrial park, we can reach an indicator of the return of ICMS for each job created. Following this line of reasoning, assuming an average wage of R\$ 1.000 for employees of the industrial district, taking into account that around 50% of their wages is spent on goods and products subject to ICMS taxation (study as POF / IBGE) and, finally, assuming an average rate of 12% for ICMS taxation (considering the proportionality of the products consumed), we would get a tax return of R\$ 60,00. It should be emphasized that this amount does not include the indirect effects of the tax collection of this newly remunerated workforce. For example: services that are hired by the new employees (schools, housekeepers, beauty salon, etc.), and of course, they create transactions subject to ICMS, given that these newly hired staff also come to buy products subject to ICMS.

Within this methodology, aimed to assess direct and indirect gains from ICMS collection deriving from the development of a tax benefit policy to industries, we quote a technical study by Cosme Maranhão.

It was based on the four pillars listed above and estimated that for each R\$ 1,00 of tax benefit granted to enterprises that come to settle in the state (PRODEPE), the return in terms of direct and indirect revenue, resulting from it (this settlement), is approximately R\$ 1,30.

Summing up these positive points and how they reflect directly and indirectly on the collection of ICMS we can gain an insight of the economic and social importance attributed to the settlement of new industries within the state. This will happen by the adoption of a serious policy of tax benefits, especially when promotes its settlement in less developed areas. And also, even without considering the whole multiplier effect of the jobs created, as in the case of professionals, that depending on the position achieved, could afford to employ others, who in turn could gain access to new income and to consuming new products.

It was this crucial policy of tax benefits, implemented by the state in recent years that allowed the creation of a new environment of economic development. It has been targeted to the interior of the state and promoted the creation of new industrial development areas. These areas, whether in the installation or consolidation phase, have favored the expansion of already present production centers as well as generating new jobs, increasing ICMS collection and average regional salaries.

This fiscal policy also allowed a greater investment by the government to meet the needs of the companies. It targeted infrastructures, training for the qualification of the workforce and the promotion of a higher commercial dynamism for small and medium enterprises.

In order to provide an idea of the volume of projects submitted to and approved by CONDIC (Board of Industrial and Commercial Development of Pernambuco) gaining access to the benefits of PRODEPE fiscal policy in the period 2007-2012, we present the following table showing the number of

projects of industrial plants approved for Development Region (RD) and the respective amounts of credit available from PRODEPE, estimated for each Development Region.

Table 3.1 - Number of projects approved in condition (2007-2012)				
Development Region (RD)	No. of Municipalities of RD	Credit Presumed (%)	Projects	
			Nº	Part%
Região Metropolitana do Recife	15	75%	342	60,30%
Mata Norte	19	85%	56	9,90%
Agreste Central	26	90%	49	8,60%
Mata Sul	24	85%	44	7,80%
Sertão do São Francisco	7	95%	24	4,20%
Agreste Meridional	26	90%	16	2,80%
Sertão do Moxotó	7	95%	11	1,90%
Agreste Setentrional	19	90%	11	1,90%
Sertão do Pajeú	17	95%	8	1,40%
Sertão do Itaparica	7	95%	3	0,50%
Sertão Central	8	95%	2	0,40%
Sertão do Araripe	10	95%	1	0,20%
Total	185		567	100,00%

Source: AD Diper / PE

For the high number of projects targeted to the Development Regions of the hinterland, especially, Mata Norte, Agreste Central and Mata Sul, one realizes that the implementation of tax benefit policies has played a key role in stimulating decentralization, encouraging the establishment of new industries in more distant areas from the Metropolitan Region or the productive expansion of those already established in the state. Even with the high percentage of participation recorded for the Metropolitan Region of Recife we can note, as recorded in the above table, the strengthening of regions that previously had little or did not have any strength in the process of economic development, such as the Mata Norte and Mata Sul and the Sertão do São Francisco.

In addition to the direct and indirect socio-economic effects of tax benefits, previously mentioned, the implementation of public policies as well as public-private initiatives that promote the development of industrial projects, directly contributes to the economic and social empowerment of the municipality

in which the industrial plant locates. That is determined by the granted annual access to funds from IPM (Municipalities Participation Index) provided by the State of Pernambuco, which is directly linked to the economic performance of companies located in the municipality.

First, however, we thought appropriate to make a quantitative comparison of registrations, stratified listed by the municipalities belonging to the industrial sector that contributed to this new VA. To this end, we prepared the following table that provides an idea not only of the geographical distribution of industrial companies within the state, but also of the level of increase in new registrations in the productive sector, occurring in each Development Region of Pernambuco between 2006 and 2012. Municipalities are listed in descending order, according to the number of companies in 2012.

Table 3.2 - Tax payers registered in the municipalities - 2006 and 2012					
Municipalities	Development Region (RD)	2006	2012	Diff 2012 - 2006	V% 2012 x 2006
Recife	RMR	515	930	415	80,60%
Jaboatão dos Guararapes	RMR	213	375	162	76,10%
Caruaru	Agreste Central	139	272	133	95,70%
Cabo de Santo Agostinho	RMR	87	161	74	85,10%
Olinda	RMR	90	154	64	71,10%
Paulista	RMR	95	154	59	62,10%
Petrolina	Sertão do São Francisco	67	121	54	80,60%
Santa Cruz do Capibaribe	Agreste Setentrional	66	109	43	65,20%
Toritama	Agreste Setentrional	27	72	45	166,70%
Abreu e Lima	RMR	40	69	29	72,50%
Vitória de Santo Antão	Mata Sul	33	69	36	109,10%
Igarassu	RMR	39	63	24	61,50%
Garanhuns	Agreste Meridional	31	53	22	71,00%
Araripina	Sertão do Araripe	31	52	21	67,70%

Camaragibe	RMR	27	52	25	92,60%
Ipojuca	RMR	24	45	21	87,50%
Goiana	Mata Norte	20	43	23	115,00%
Limoeiro	Agreste Setentrional	31	43	12	38,70%
Bezerros	Agreste Central	26	38	12	46,20%
São Lourenço da Mata	RMR	19	38	19	100,00%
Belo Jardim	Agreste Central	21	35	14	66,70%
Trindade	Sertão do Araripe	16	30	14	87,50%
Gravatá	Agreste Central	17	27	10	58,80%
Moreno	RMR	21	27	6	28,60%
Carpina	Mata Norte	12	26	14	116,70%
Timbaúba	Mata Norte	9	26	17	188,90%
Escada	Mata Sul	10	24	14	140,00%
Pesqueira	Agreste Central	14	24	10	71,40%
Paudalho	Mata Norte	13	23	10	76,90%
Subtotal (29 municípios)		1753	3155	1402	80,00%
Demais municípios (156)		318	573	255	80,20%
Total dos municípios		2071	3728	1657	80,00%

Source : Sefaz / PE

Due to its level of economic development, the available supply of a more skilled and specialized workforce, and the proximity of the port structure already present in Pernambuco, it is perfectly natural that the Metropolitan Region of Recife has welcomed the highest number of newly registered industrial taxpayers, both in 2006 and in 2012.

In spite of this predominant metropolitan development, we have to highlight the growing industrial base that is settling into some areas of the interior of the state, such as the municipalities of Caruaru, Petrolina, Toritama, Goiás, Carpina, Timbaúba, Vitória de Santo Antão and Escada, which reached significant increasing percentages in the registration growth of new industries.

In addition to this expansion in the degree of development of the interior of the state, is worth highlighting the arrival of 1,657 new companies to the state between the years 2007-2012. Upon analyzing the distribution figures of the 1,402 Companies industries, newly resident in the 29 major cities listed above, we can identify 504 new taxpayers that settled outside the metropolitan area of Recife, i.e 36% of the new industries established themselves in the main

developing regions of the interior. We believe that the policies of state tax benefits aimed at the industrial sectors, especially, the PRODEPE program, have greatly contributed to the settlement of companies in peripheric business centers, given the proportionality of the incentives to the distance of the chosen location from the metropolitan area of Recife, that is to say, the farthest the location is from Recife, the highest tax incentives will be.

Coming back to the analysis of the IPM (Municipalities Participation Index), the state government, under federal law, must annually calculate the IPM in order to allocate to their municipalities the amount of 25% of all proceeds resulting from the payment of ICMS, during the current financial year, (according the constitutional law). The share of IPM, allocated to each municipality is 75% in proportion to the Value Added (VA) and 25% related to socio- environmental indicators, which can be regulated by the initiative of the state governments. As the weight of the VA (75%) is considerably representative in the calculation of IPM, the recorded annual results and developments will be taken into analysis to establish the levels of state funds granted; improving the prospects of municipal budgets which would allow a greater use of public initiative to their population benefit.

Regarding the VA, resulting from the subtraction between sales declared by companies and their respective purchases in the last two years preceding the determination of the VA, is to be considered in the calculation of IPM of the following year. This calculation reflects the level of economic development of the municipality, considering all the economic information provided by all its ICMS taxpayers, regardless of business size and economic sector.

In order to measure the effects of the implementation of industrial projects sponsored by the PRODEPE program within municipalities and their Development Regions, it is important to analyse the evolution of the VA calculated for the years 2006 (period prior to analysis), 2008 and 2011, in the major cities of the state and, wherever possible, link them to the number of projects mentioned in Table 3.1.

To this end, we can look at table 3.3 that discriminates VA for those periods and calculates the percentage of evolution achieved between 2006 and

2011. Besides this information, we included in the table the number of the newly registered industries in the municipalities in the period 2007-2012. It is not mentioned in the table the final value added VA for 2012 as it had not been published at the time of the gathering of this data. The municipalities are listed following a descending order in the VA percentage of evolution (2011 x 2006).

Table 3.3 - Added Value by Municipalities in the calculation of IPM

Municipalities	New Industries	Added Values (Million BRL)			Var% (2011 x 2006)
		2006	2008	2011	
Vitória de Santo Antão	36	257,7	383,8	1.023,40	297,10%
Escada	14	54	132,1	201,7	273,50%
Carpina	14	95,9	165,5	348,5	263,40%
Santa Cruz do Capibaribe	43	108,1	155,6	283,1	161,90%
Toritama	45	44,8	54	112,3	150,70%
Pesqueira	10	60,7	80,9	148,1	144,00%
Timbaúba	17	87,9	93,2	207,7	136,30%
Paulista	59	398,7	639	936,6	134,90%
Gravatá	10	72,7	97,9	169	132,50%
Garanhuns	22	221,6	251,1	497,1	124,30%
Cabo de Santo Agostinho	74	1.813,50	3.560,40	4.036,30	122,60%
Goiana	23	209	305,3	447,3	114,00%
Olinda	64	898,3	1.197,00	1.875,40	108,80%
Caruaru	133	736,6	913	1478,3	100,70%
São Lourenço da Mata	19	74,6	86,8	148,4	98,90%
Jaboatão dos Guararapes	162	3.266,2	4.167,8	6.420,8	96,60%
Camaraçipe	25	118,4	136,8	227,1	91,80%
Petrolina	54	691,6	876,4	1.294,2	87,10%
Trindade	14	37,9	53,3	69,8	84,20%
Araripina	21	77,4	100,4	142,1	83,60%
Paudalho	10	53,3	51,5	93,3	75,00%
Abreu e Lima	29	401,7	460	680,2	69,30%
Recife	415	10.087,80	11.798,20	16.623,40	64,80%
Limoeiro	12	45,4	55,1	72,9	60,60%
Belo Jardim	14	242	232,8	376,2	55,50%
Igarassu	24	505,8	619,5	783,7	54,90%
Ipojuca	21	4.019,40	3.960,20	6.159,20	53,20%
Bezerros	12	42	49,1	62,9	49,80%
Total do Municípios	1.657	27.132,40	34.287,40	50.047,80	84,50%

Source: Sefaz/PE

As mentioned, the value added works as thermometer of the economic performance of the municipalities as it makes measurements of the dynamics of purchases made by local taxpayers and citizens, as well as representing the level of sales of the companies settled in the cities, regardless of the destination, whether local or directed to other regions. Even the settlement of few industrial enterprises, provided they are large in business size provides not only economic and social gains, but also the access to additional funds from the state government to be received annually by the city, which was awarded the project.

An example of this reasoning is given by the future arrival of factories WHB (engine blocks) and Nissin Ajinomoto (food) in the municipality of Glória do Goitá (Mata Norte). The implementation of the two plants will, in the near future, determine a large increase in the inflow of state resources (IPM) through the value added generated by them, allowing the municipality to adopt new public policies that foster a better quality of life for its citizens.

Regardless of the number of new industries allocated to municipalities - few large ones are enough, as in the case of Glória do Goitá - we find that fourteen municipalities, including twelve RDs, belonging to the hinterland so outside the Metropolitan Region of Recife, achieved a percentage of evolution 2011 x 2006, higher than 100% (when the State average was 84.5%). This picture confirms, once again, the economic strength that the interior is gaining by, decentralizing greatly the state economic dynamism, fuelled no doubt by the settlement of industrial plants benefited by PRODEPE program.

The municipality of Vitoria de Santo Antão (Mata Sul), as is known, presents itself as a new hub for the development of the interior, and his leadership reflected in Table 3.2 consolidates its position at the economic forefront. A major reason of this success is to be found in the opening in November 2013, of the first major commercial center (Vitória Park Shopping), to meet the strong demand for consumption, locally and from regions adjacent to the city.

As the calculation of the value added, includes the performance of commercial businesses (retail and wholesale) as well as industrial one, the

benefits in calculating the VA coming from the commercial sector, is related to the consumer classes present in the municipalities. This is, of course, linked to generation of employment and improvements in level of income offered by companies. This higher level of consumption is found in a very impressive manner, near the settlement of industrial projects that bring social benefits to the local and surrounding population, as it has been happening with Vitoria de Santo Antão, that in a few years, welcomed industrial plants of the size of Sadia(factories), Kraft Foods and Isoeste. There is no doubt that workers of these companies, whether or not domiciled in Victoria, began to consume in establishments present in the city, providing an increase in the level of commercial sales and thus ensuring a higher level of VA for the municipality.

Analysing further the harmony between the data contained in tables 3.1 and 3.2, we can note the almost symmetrical economic development performance of the Mata Sul (Vitória and Escada), Mata Norte (Carpina, Timbaúba and Goiana), Agreste Central (Caruaru and Gravatá) and RMR (the municipalities of Paulista, Cabo de Santo Agostinho and Olinda). As for the Metropolitan Region of Recife, mainly Recife city, it appears that seven of the fifteen municipalities belonging to the region, showed an evolution percentage of VA of less than 100%. So in terms of VA growth detailed in Table 3.2, we note that the municipalities that already had more established commercial and industrial centers (Jaboatão Guararapes and Ipojuca), or that did not receive new structural projects (Abreu e Lima) or which lacked areas suitable to the creation of industrial parks (Recife), were not presenting the highest rates of value added evolution.

We can expect, in the forthcoming years 2015/2016, considerable future added value with strong local effects on state resources, from the complete implementation of automotive poles (FIAT), pharmacoquimico (Hemobrás), glassmaker (Vivix - Flat Glass), structural projects that were granted tax relief, in the city of Goiana, as well as from Ipojuca, due to the Abreu e Lima Refinery, Petroquímica Suape and the expansion of the naval construction sector (Atlantico Sul Shipyard and Vard Promar).

From the foregoing, there is no doubt about the strong connection between the implementation of tax relief policies by PRODEPE Pernambuco, PRODEAUTO and PRODINPE and the economic advances made in recent years by many Municipalities, especially those of the interior.

This promising environment of tax incentives, which promoted the settling of hundreds of industrial plants as well as the consolidation of the wholesale network, reaffirming its vocation as a distribution center, and, of course, the booming trade from the retail sector, represent the undeniable responsibility of the federal government, the federal entities and society as a whole in determining future national policies aiming to minimize social differences between different regions of the country, without damaging what has already been achieved by the less favoured States.

4 - The New Economy of Pernambuco and National Indicators

4.1 GDP Growth (Gross Domestic Product), according to IBGE

As reported in the media, Pernambuco, with reference to GDP, has been presenting figures considerably higher than the Northeastern Region (Gross Domestic Product - GDP), as well as higher percentages in terms of annual national growth . The table below shows the leadership of the State in the majority of the years taken into consideration and points to an average GDP growth higher than the states of Bahia and Ceará, overtaking the national one.

The states of Bahia and Ceará were chosen to be presented in the surveys due to join the same region and have similar economies.

Table 4.1 - Percentage variation in GDP (Gross Domestic Product)								
States	Annual Percentage Variation (%)							
	jun-14	jul-14	ago-14	set-14	out-14	nov-14	dez-14	Average
Pernambuco	5,40%	5,30%	2,80%	9,30%	5,70%	3,70%	4,20%	5,20%
Bahia	4,50%	5,20%	1,70%	7,50%	2,00%	3,10%	3,00%	3,90%
Ceará	3,30%	6,50%	3,10%	7,90%	4,30%	3,60%	4,00%	4,70%
Brasil	6,10%	5,20%	-0,30%	7,50%	2,70%	1,00%	2,30%	3,50%

Source : IBGE / Condepe Fidem-Pernambuco/IPECE-Ceará/SEI-Bahia

Note: GDP for 2012 and 2013 are estimated

The GDP recorded for the years 2012 and 2013 is the result of estimates of state institutions drawn up together with IBGE . Even with projected numbers, the state stands out with more favorable indicators and positive expectations regarding the fulfilment of structuring projects in the coming years, such as the Abreu e Lima refinery , FIAT, Petroquímica Suape, Hemobrás and Vivix - Flat Glass.

Another panorama of state GDP growth can be observed through the values of GDP of the states and regions considered , as shown in Table 4.2 , confirming that , with the exception of Ceará , Pernambuco achieved the greatest variation in the period 2006/2011.

Table 4.2 – Nominal Gross Domestic Product (GDP) - 2006 and 2011 (current values in Million BRL)					
State	GDP			Part% Brazil	
	2006	2011	Var%	2006	2011
Pernambuco	55.493,00	104.394,00	88,10%	2,30%	2,50%
Bahia	96.521,00	159.869,00	65,60%	4,10%	3,90%
Ceará	46.303,00	87.982,00	90,00%	2,00%	2,10%
Nordeste	311.104,00	555.325,00	78,50%	13,10%	13,40%
Brasil	2.369.484,00	4.143.013,00	74,80%	100,00%	100,00%

Source : IBGE, Research Institutions and Secretaries of State Planning

In appraisal of the table in question, we can see very positive changes (2011/2006) of Nominal GDP for Ceará and Pernambuco, when compared to Bahia , the Northeast region and Brazil. In terms of participation to Brazilian GDP, the Northeast region increased its economic influence in Brazil's GDP by 0.3%, with strong contribution from Pernambuco (+0.2%) and Ceará (+0.1%). In order to show the performance of the annual GDP of the states in the years in analysis (2006-2011), we present in table 4.3 the percentage changes in values, year by year, highlighting the periods in which each state had the best performance.

Table 4.3 - Annual percentage change of Nominal GDP						
States	GDP - Annual Variation (%)					
	2007/ 2006	2008/ 2007	2009/ 2008	2010/ 2009	2011/ 2010	2011/ 2006
Pernambuco	12,20%	13,10%	11,30%	21,40%	9,70%	88,10%
Bahia	13,60%	10,80%	12,80%	12,60%	3,60%	65,60%
Ceará	8,70%	19,40%	9,30%	18,50%	13,00%	90,00%
Brasil	12,30%	13,90%	6,80%	16,40%	9,90%	74,80%

Source : IBGE, Research Institutions and Departments of State Planning

As seen in the table, the difference in GDP between Pernambuco and Ceará was favorable to Pernambuco in the years 2007, 2009 and 2010, and to the state of Ceará in 2008 and 2011. The State of Bahia showed stronger performance in the years 2007 and 2009, also contributing to a greater Northeastern participation in Brazil.

According to the Nominal GDP by Development Region (RDs) in Pernambuco, available on the Condepe/Fidem site, tables were drawn up detailing the percentage change between the years 2006 and 2010, also listing the percentage of RDs contribution in relation to the total GDP of the state. They list the Development Regions, the quantity of municipalities belonging to each RD (in brackets) and aims to demonstrate how the production of goods and services developed in each RD, in the context of its contribution to the profile of the new economy of Pernambuco.

Table 4.4 – Nominal Gross Domestic Product (GDP) by Region Development (RD) (current values in Million BRL)					
Region Development (RD) and Quantitative Municipalities	GDP			Participation%	
	2006	2010	Var%	2006	2010
Região Metropolitana do Recife (15)	36.146,50	61.476,80	70,10%	65,10%	64,60%
Agreste Central (26)	4.227,40	7.222,40	70,80%	7,60%	7,60%
Mata Sul (24)	2.786,50	4.921,30	76,60%	5,00%	5,20%
Sertão do São Francisco (7)	2.352,80	4.155,60	76,60%	4,20%	4,40%
Mata Norte (19)	2.385,00	3.977,10	66,80%	4,30%	4,20%
Agreste Meridional (26)	2.153,70	3.761,60	74,70%	3,90%	4,00%
Agreste Setentrional (19)	1.584,90	2.912,50	83,80%	2,90%	3,10%
Sertão do Pajeú (17)	1.062,50	1.775,60	67,10%	1,90%	1,90%
Sertão do Araripe (10)	854,60	1.527,60	78,80%	1,50%	1,60%
Sertão de Itaparica (7)	762,50	1.323,00	73,50%	1,40%	1,40%
Sertão do Moxotó (7)	656,30	1.168,80	78,10%	1,20%	1,20%
Sertão Central (8)	520,80	964,50	85,20%	0,90%	1,00%
Total (185)	55.493,50	95.186,80	71,50%	100,00%	100,00%

Source: Condepe Fidem/PE

The panorama in Table 4.4 displays an expansion in GDP of the regions not linked to the Metropolitan Region of Recife, which denotes a decentralization of state development towards the hinterland Development Regions. In this sense we can note the increased contribution of Mata Sul (+0.2%), led by the cities of Vitória de Santo Antão and Escada (industrial expansion), Sertão do São Francisco (+0.2%), with the strong performance of the municipality of Petrolina (due to extensive irrigation projects), Agreste Meridional (+0.1%), led by the municipality of Garanhuns (agriculture), Agreste Setentrional (+0.2%), driven mainly by economic expansion in the municipalities of Santa Cruz do Capibaribe, Toritama and Surubim (textile hub); Sertão do Arararipe (+0.1%) through the representativeness of Araripina (gypsum polo), and Sertão Central (+0.1%) taking as an example of development the city of Salgueiro (civil construction).

Even with GDP growth below the average recorded for the State between 2006 and 2010 (+71.5%), we focus on economic growth in the Metropolitan Area of Recife (+70.1%), highlighting the municipality of Ipojuca, with an outstanding variation of 110.0% in GDP, achieved especially through the business enterprises located in the Port of Suape . With regards to the performance of Agreste Central (+70.8%), Caruaru presents itself as largely responsible for the significant progress which took place between 2006 and 2010 with 70.4% increase.

Although the Mata Norte has recorded a GDP growth of 66.8% (below the average of 71.5%) in the coming years, the region is expecting a new wave of economic development, which would have a significant impact on its GDP, given the implementation of auto polo (FIAT), the farmacoquímico (Hemobrás) and glassmaker (Vivix Windows plans), all to be located in the city of Goiana, which, between 2006 and 2010, reached its GDP percentage change in the order of 65.9% (table 4.5).

In line with the analysis of regional development within the state in terms of Nominal GDP, we list in Table 4.5 the 50 largest cities which recorded GDP of over R\$ 200 million in 2010, amounting to 87% of the state GDP. In Table 4.5

these municipalities are presented with their respective percentage changes between 2006 and 2010 and listed in descending order of 2010 GDP figures.

**Table 4.5 – Variation of Nominal GDP by municipalities
(at current values in Million BRL)**

Municipalities	Region Development (RD)	GDP		
		2006	2010	Var%
Recife	Região Metropolitana Recife	18.316,70	30.032,00	64,00%
Ipojuca	Região Metropolitana Recife	4.331,20	9.095,10	110,00%
Jaboatão dos Guararapes	Região Metropolitana Recife	4.738,20	8.359,60	76,40%
Cabo de Santo Agostinho	Região Metropolitana Recife	2.828,70	4.476,20	58,20%
Petrolina	Sertão do São Francisco	1.772,70	3.149,20	77,60%
Olinda	Região Metropolitana Recife	2.007,80	3.108,00	54,80%
Caruaru	Agreste Central	1.763,10	3.003,60	70,40%
Paulista	Região Metropolitana Recife	1.223,50	2.129,70	74,10%
Vitória de Santo Antão	Mata Sul	666,9	1.252,60	87,80%
Igarassu	Região Metropolitana Recife	663,9	1.146,80	72,70%
Garanhuns	Agreste Meridional	636,2	1.140,10	79,20%
Abreu e Lima	Região Metropolitana Recife	544,2	847,8	55,80%
Belo Jardim	Agreste Central	397,9	784,6	97,20%
Camaraçibe	Região Metropolitana Recife	459,2	756,8	64,80%
Goiana	Mata Norte	442,7	734,3	65,90%
Serra Talhada	Sertão do Pajeú	362,5	708,6	95,50%
Petrolândia	Sertão do Itaparica	435,7	705,4	61,90%
Santa Cruz do Capibaribe	Agreste Setentrional	290,4	579,3	99,50%
Carpina	Mata Norte	311,5	578,3	85,70%
São Lourenço da Mata	Região Metropolitana Recife	286,4	522,1	82,30%
Itapissuma	Região Metropolitana Recife	405,4	479,4	18,30%
Escada	Mata Sul	222,5	473,5	112,80%
Gravatá	Agreste Central	276,1	473,2	71,40%
Palmares	Mata Sul	262,2	467,2	78,20%
Timbaúba	Mata Norte	280,4	445,7	59,00%
Salgueiro	Sertão Central	204,5	445,5	117,80%

Arcoverde	Sertão do Moxotó	259,9	415,9	60,00%
Araripina	Sertão do Araripe	235,3	413,7	75,80%
Surubim	Agreste Setentrional	186,4	357,5	91,80%
Pesqueira	Agreste Central	212,8	345,8	62,50%
Bezerras	Agreste Central	213,7	337,2	57,80%
Limoeiro	Agreste Setentrional	201,5	324,7	61,10%
Sirinhaém	Mata Sul	165,8	319	92,40%
Bom Conselho	Agreste Meridional	139,9	310,6	122,00%
Ouricuri	Sertão do Araripe	179,6	309	72,00%
Moreno	Região Metropolitana Recife	196,5	303,7	54,60%
Floresta	Sertão do Itaparica	134,7	286,2	112,50%
São Bento do Uma	Agreste Central	174,5	285,3	63,50%
Santa Maria da Boa Vista	Sertão do São Francisco	203,4	274,6	35,00%
Buíque	Agreste Meridional	153,1	272,6	78,10%
Paudalho	Mata Norte	156,5	264,7	69,10%
Ribeirão	Mata Sul	143,9	255,9	77,80%
Lagoa Grande	Sertão do São Francisco	134	251,7	87,80%
Nazaré da Mata	Mata Norte	145,1	232,4	60,20%
Lagoa de Itaenga	Mata Norte	114,7	222,7	94,20%
Toritama	Agreste Setentrional	108,3	222,2	105,20%
Custódia	Sertão do Moxotó	100,8	207,6	106,00%
Bonito	Agreste Central	140	203,3	45,20%
Itambé	Mata Norte	133,1	201,6	51,50%
Barreiros	Mata Sul	125,4	201,2	60,40%
Total (50 municípios)		48.089,40	82.713,70	72,00%

Source : Condepe Fidem / PE

Even considering that this study aims to identify the new profile of the economy of Pernambuco from the perspective of revenue in the industrial, wholesale and retail business for the period 2007-2012, we ought to consider the relationship between GDP growth in the period 2006-2010 (Table 4.5) and the increment in the number of registered taxpayers between) 2006 to 2012 in several municipalities in the state. It is the case of municipalities that have achieved positive growth (above 80% of GDP) and have recorded an increase in the number of registered of taxpayers : Ipojuca (110% GDP growth and taxpayers increase of approximately 166.7%), Vitoria de Santo Antão (87.8% and 136.1%), Santa Cruz Capibaribe (9.5% and 114.1%), Escada (112.8% and 179.3%), Salgueiro (117.8% and 159.5%), Carpina (85.7% and 108.2%) and São Lourenço da Mata (2.3% and 150.0%).

4.2 Growth of Industrial output according to IBGE

Based on Monthly Surveys of the Industry (PMI), published by IBGE, we drafted table 4.6 to demonstrate the positive performance of the industrial indicator (Regional Physical Production) for the Pernambuco industrial sector in relation to Brazil and to the states of Bahia and Ceará.

Table 4.6 - Percentage change of the indicator of real production (Monthly Survey of Industry / IBGE)								
States	Annual Percentage Variation							
	2007/ 2006	2008/ 2007	2009/ 2008	2010/ 2009	2011/ 2010	2012/ 2011	2013/ 2012	Average
Pernambuco	4,80%	4,10%	-2,90%	10,20%	0,00%	1,30%	0,80%	2,60%
Bahia	2,00%	2,40%	-4,80%	7,10%	-4,40%	4,30%	3,80%	1,50%
Ceará	1,20%	2,50%	-3,80%	9,20%	-11,50%	-1,20%	3,30%	-0,10%
Brasil	6,00%	3,10%	-7,40%	10,50%	0,40%	-2,60%	1,20%	1,60%

Source : IBGE / Monthly Survey of Industry

This production indicator compares the industrial output in the last 12 months of reference, over the immediately preceding period. The picture presented above illustrates the especial timing of the state of Pernambuco under the industrial scenario, showing a positive behaviour compared to the states of Ceará and Bahia, submitting the highest average industrial growth in the term under scrutiny, even outperforming the recorded Brazilian average.

Even in 2009, when it suffered a strong impact of the global and national economic crisis, Pernambuco had the smallest reduction in the productivity of its plant. The arrival of several companies to the State, in recent years, has provided not only a wider range of production lines installed there, but also a more diversified production of goods and products, which must have contributed to lessen the effects of the economic crisis experienced in 2009.

4.3 Retail growth, according to IBGE

In the retail sector, the Monthly Retail Trade Survey, published by IBGE, which aims to measure the revenue of sales in the retail trade sector, also reflects a significant growth of consumption in Brazil and the major Northeast states analysed over six years (2007-2013). Differently from what shown in the analysis of the industrial sector, Pernambuco has no leadership on the average of the indicators against the Northeastern states (Ceará had the best performance), but delivers a sustainable percentage of annual revenue growth in the commercial sector, as we can see in Table 4.7.

Table 4.7 - Percentage change revenue from the retail trade sector (Monthly Survey of Trade / IBGE)								
States	Annual Percentage Variation							
	2007/ 2006	2008/ 2007	2009/ 2008	2010/ 2009	2011/ 2010	2012/ 2011	2013/ 2012	Average
Pernambuco	16,60%	13,10%	9,30%	17,10%	8,40%	11,00%	11,00%	12,40%
Bahia	14,00%	13,80%	8,60%	13,90%	7,00%	12,40%	7,50%	11,00%
Ceará	15,80%	16,60%	11,80%	20,10%	10,10%	10,90%	6,00%	13,00%
Brasil	15,10%	15,10%	7,80%	15,10%	9,40%	9,50%	8,90%	11,60%

Source : IBGE / Monthly Survey of Trade

4.4 Unemployment Rate of Major metropolitan areas, according to IBGE

After this introduction of positive signs shown in the economic field, we are going to evaluate the social repercussions of the economic expansion recorded in the state, through IBGE (Table 4.8) showing the large reduction in the unemployment rate experienced over the years in question.

Table 4.8 - Unemployment rate in the major metropolitan areas (December) / Monthly Job research / IBGE

Metropolitan Area	Unemployment Rate (%)								Reduction Rate
	2006	2007	2008	2009	2010	2011	2012	2013	
Recife	10,40%	9,90%	7,80%	8,40%	6,90%	4,70%	5,60%	5,90%	-43,30%
Salvador	12,40%	11,40%	10,00%	10,70%	8,40%	7,70%	5,70%	7,70%	-32,50%
Belo Horizonte	7,10%	5,50%	5,50%	5,10%	4,30%	3,80%	3,50%	3,40%	-38,20%
Rio de Janeiro	6,50%	6,10%	6,20%	5,40%	4,90%	4,90%	4,00%	3,70%	-39,30%
São Paulo	9,00%	8,00%	7,10%	7,50%	5,30%	4,70%	5,20%	4,40%	-45,00%
Porto Alegre	6,60%	5,30%	4,70%	4,30%	3,00%	3,10%	3,00%	2,60%	-50,90%
Total	8,40%	7,50%	6,80%	6,80%	5,30%	4,70%	4,60%	4,30%	-42,70%

Source : IBGE / Monthly Survey of Employment

As illustrated (shown), the metropolitan Area of Recife has achieved a considerable reduction in unemployment rate between 2006 and 2013. The percentage of -43.3% was ahead of the indicators presented by metropolitan areas with the exception of Porto Alegre and São Paulo. Despite of the end of big construction project in a short and medium term projects that had absorbed a lot of manpower, e.g. the Abreu e Lima Refinery and Petroquímica Suape, the State ought to maintain these percentages with the construction of other industrial centers such as the automotive (FIAT), pharmaceutical-chemical (Hemobrás), and other enterprises with great potential for employing workers.

4.5 Growth of Revenue from ICMS, according to Confaz

Table 4.9 reports data from the portal of the National Council for Financial Policy (Confaz) of the Ministry of Finance (MF) that addresses the ICMS collection of Pernambuco, Bahia, Ceará and Brazil. The aim of this table is to compare the level of ICMS collection in the state of Pernambuco to the major states in the Northeast and Brazil, considering a seven years period (2007-2013) and its annual percentage changes.

Table 4.9 - ICMS Percentage change / Confaz / Ministry of Finance								
States	Annual Percentage Variation							
	2007/ 2006	2008/ 2007	2009/ 2008	2010/ 2009	2011/ 2010	2012/ 2011	2013/ 2012	Average
Pernambuco	11,30%	14,60%	10,60%	22,50%	18,00%	6,80%	10,50%	13,50%
Bahia	3,90%	14,50%	-0,90%	19,70%	9,00%	9,20%	16,50%	10,30%
Ceará	4,30%	20,50%	8,80%	19,80%	10,50%	12,50%	13,80%	12,90%
Brasil	9,10%	17,60%	4,00%	18,00%	13,50%	6,30%	7,80%	10,90%

Source : Confaz / MF / Secretaries of Finance

Note : ICMS in Brazil in 2013 registered as provisional (as of 21/02/14)

Noteworthy is the outstanding growth of Pernambuco occurred in the years 2009-2011, especially in 2009, in view of the poor economic expansion which occurred in that year, not only in the Northeast but throughout Brazil, due to the severe global and national economic crisis. In the last years of the series (2012/2011 and 2013/2012), Pernambuco registered lower positions in relation to the states of Bahia and Ceará, without, however, yielding, its leadership in ICMS collection growth in terms of annual average, in the seven years under review.

Table 4.10 – Participation at total collection - 2006 and 2013 (current values in Thousand BRL) (current values in million BRL)						
State	ICMS			Part% Brazil		Var. Part%
	2006	2013	Var%	2006	2013	2013/ 2006
Pernambuco	4.864.103,00	11.711.614,00	140,78%	2,83%	3,27%	15,72%
Bahia	8.940.621,00	16.831.542,00	88,26%	5,20%	4,70%	-9,52%
Ceará	3.755.799,00	8.705.389,00	131,79%	2,18%	2,43%	11,4%
Nordeste	25.995.288,00	57.418.861,00	120,88%	15,11%	16,04%	6,16%
Brasil	172.058.673,00	357.993.860,00	108,06%	100,00%	100,00%	

Source : CONFAZ/MF

From Table 4.10 it can be observed that the state of Pernambuco in the period 2006-2013 reached a nominal growth of ICMS collection of approximately 140% getting the best result among the three states analysed. This result meant that the relative share of the ICMS collection of Pernambuco

in Brazil's total revenues had increased from 2.83% to 3.27% (up 15.72%), arguably the best result.

The environment of opportunities generated by the installation of structural projects such as the Atlântico Sul Shipyard, the Abreu e Lima Refinery and Petroquímica Suape, as well as the prime location of the state and the modern infrastructure of the Port of Suape, combined with a consistent policy of fiscal incentives, have attracted hundreds of companies that are contributing to the expansion of the tax base, providing impulse to the economy of Pernambuco.

We also need to consider the high level of investments made by the State to provide the business community with the necessary conditions for the successful installation of new enterprises, including the development of policies that support the creation of industrial districts, the supply of strategic resources (water, power and gas), and the application of finances resources in order to improve mobility.

Important to the result achieved, in addition to these strategic factors is the emergence of a new consumer range that originated from the high employment rate which occurred in the State.

To this, contributed greatly the installation of new businesses as well as the implementation of public policies aimed at raising the spending power of the lower social classes, determining the expansion of the tax base to which we refer.

4.6 International Trade Growth

Table 4:11 indicates a growth in total exports of Pernambuco between 2007 and 2013 of 128%, leading to an improvement of the state's share of total exports from Brazil of 0.5% to 0.8%, representing an increase of 51.7%, mainly due to the start of exports of the shipbuilding industry.

Table 4.11 Exportations (nominal values - Million BRL)			
State	2007	2013	Var.%
Pernambuco	870,60	1.991,50	128,80%
Brasil	160.649,10	242.178,60	50,80%
Partic. PE	0,50%	0,80%	51,70%

Source: Sefaz/PE

Moreover, in relation to imports, Table 4.12 shows that in the same period, the impact of the new economy of Pernambuco caused a strong increase of 296.9%, so much higher than the national rate - 98.7%. In this case the State has doubled their share of total imports of the whole country. This result was due mainly to the strong growth of the wholesale import of capital goods for installation of new industrial units.

Table 4.12 Importations (nominal values - Million BRL)			
State	2007	2013	Var.%
Pernambuco	1719,60	6.824,30	296,90%
Brasil	120.620,90	239.620,90	98,70%
Partic. PE	1,40%	2,80%	99,80%

Source: Sefaz/PE

4.7 Human Development Index

The HDI is a general measure of human development. It is comprised of three components: health, education and life expectancy.

According to the study research of PNUD – United Nation Development Program – the HDI of the state of Pernambuco improved more than the Brazilian HDI from 2000 to 2010.

Table 4.13 HDI – Variation of the Human Development Index 2000- 2010			
State	2000	2010	Var.%
Pernambuco	0,544	0,673	23,71%
Brasil	0,612	0,727	18,79%

Source: PNUD

Despite this fact and that there are a few some individual cases of municipalities in which the HDI has shown some improvement is evident by comparing the HDI of Pernambuco with the Brazilian one that the expected development is still under way.

5 - Conclusion

The organization of Brazil, based on a federalist model, has favored the emergence of disputes between Member States in order to attract investments. This dispute which, was renamed the "fiscal war", revolves around the main state tax, the ICMS. In the state of Pernambuco, in particular, from 1994 to the present, this competition is achieving important effects on economic growth.

This phenomenon manifests itself as an externality contemplated in the theory of public finance, which influence the level of total tax revenues of the governments involved and, consequently, the level of services made available to society by these governments.

It is pertinent to emphasize that federalism adopted in Brazil, where regional and provincial oligarchies exerted considerable political, economic and social influence, inherited the practice of using taxes as an instrument of development policy over the centuries. Moreover, as the formation of Brazilian federalism did not keep any relationship with the national ideology or even with the theoretical thinking of that time, he was directed to meet the personal interests of political and economic elites, instead of setting up a national strategy of government.

With this kind of framework, it becomes almost impossible to dissociate practices that are directed to particular interests from structural issues in the public interest. As a result, in Brazil we coexists with a picture of stark regional inequalities, which directly affects regions outside the Southeast and South of the country, particularly the Northeast.

Creating thus a vicious circle in which the region is not developed because it has no infrastructure and has no infrastructure because is not developed. For a change of course is necessary a new political- administrative design capable of implementing national integrated policies of development.

Moreover, considering that it is almost commonplace in many federal systems that adopt the federalist model, the practice of tax competition among subnational governments, we ought to stress the need for the federal

government to play the role of coordinator, assuming thus its responsibility. Otherwise this competition, if practiced fiercely, will lead to a federal imbalance of the member states with uncontrollable consequences for the country as a whole.

The study identified the emphasis that is given to programs aimed to attracting investments that have been adopted by the state governments, primarily for the industrial sector. The priority sectors contemplated were: petrochemical, metallurgy, shipbuilding, glassmaking, pharmaceutical, food, footwear, plastics, automotive and wind generation.

It is known that these choices had as determining factors, the existing locational advantages in the state, such as the port of Suape, the refinery and petrochemical complex in consolidation, with the consequent chain of suppliers, can positively influence the decision of entrepreneurs whether to invest in the region, besides the fact that the state of Pernambuco is located in a strategic geographical position, which facilitates the flow of production to the markets domestic and international consumers.

With regards to the fact that the state development policy adopted the main state tax as a tool to attract investment, we proved that this practice is not new at all. However, it was not until the mid-90s, with the adoption of the neoliberal model characterized by market liberalization and the opening to foreign trade as well as the existence of surplus international financial capital available for investment in emerging countries, that was witnessed a strong intensification of the use of this tax in order to attract investment.

It was established from the analysis undertaken that in the current competitive process taking place within the Brazilian federation we can identify structural and cyclical factors.

Under the first perspective, of a structural nature, we go back to the history of Brazilian federalism itself, which has always been at the service of the dominant political and economic groups and therefore bound to meet individual interests without any concern for the interests of Brazilian society as a whole. This was evident in the study, when it was observed that, even at times when

the federal government intervened in the economy through the formulation of macroeconomic policies, the weight of the oligarchs was ever-present.

Under the second perspective, the situational factors identified, among other things, that the adoption of the neoliberal model allowed the resumption of foreign investment. Capitals began to flow to the states, and the foreign companies obtained public resources for their investments, through expert consultants, known as "lobbyists".

Thus, the analysis of the effects the policy adopted by the government of the State of Pernambuco for attracting investments, in the context of a fierce tax competition environment, even though no additional data for a more accurate assessment are available, allows the following conclusions:

- a) there was industrial growth in Pernambuco with some degree of spatial decentralization towards the interior of the state;
- b) segments characterized by an easy mobility of their capital settled in the state because of the granting of tax and financial incentives, as is the case of the food industry in the municipality of Vitoria de Santo Antão, and industrial beverage complexes, located in some municipalities of Pernambuco;
- c) the segments that have lower mobility of capital, such as, the enterprises of the petrochemical chain, naval construction and automotive sectors, settled, not only attracted by higher profit margins, due to the (financial) tax incentives offered, but also because of the traditional production factors offered (proximity to consumers, skilled labor, infrastructure), and the already diversified industrial park in the state.

Therefore, it shows that Pernambuco, of all the states in the Northeast, which adopted the same development policy model, was the state with the highest growth in the region in the period between 2006 and 2013. As shown in Chapter 4, Pernambuco State recorded an increase of its stake in Brazil's GDP from 2.3% in 2006 to 2.5 % in 2011. It might seem little in nominal terms, however, represents an increase of 8.7% in its relative contribution.

Another indicator used to measure the level of growth of the state is the increase in the volume of international trade in goods in the period 2007-2013,

as shown in section 4.6. During this period exports grew in the order of 128 %, while imports that had the remarkable growth of 296 %, which doubled the participation of Pernambuco in the whole Brazilian imports.

Adding to this indicator, data from ICMS collection we are able to state this policy has constituted a success for the state. The analysis of the collection of this tax in the State of Pernambuco, when compared to the collection of other Brazilian states, reveals that, despite all the tax benefits granted, showed an increase from 2.83 % in 2006 to 3,27 % in 2013 of the total ICMS collected in Brazil, while the Northeast Region in the same period increase only from 15,1% to 16,0% and the Southeast Region in the period considered, recorded a decrease in its share of the national total, from 55.0 % to 52.3 %.

Considering the effect of the incentives on unemployment rate, which we presented in Chapter 4, the metropolitan region of Recife achieved a considerable reduction of 43.3 % in the rate of unemployment between 2006 and 2013, placing it among the top three results for Brazilian metropolitan regions.

In addition to these indicators, which allow some degree of accuracy in describing the aggressive tax policy of the state, we took into consideration the behavior of the participation rate in each municipality, determined by the State Treasury, which takes into account for its calculation the company's revenue. This index has shown positive changes in almost all the municipalities covered by the program, as demonstrated in Chapter 3.

If, on the one hand, there is no doubt about the recent economic growth of the State of Pernambuco, supported by an aggressive policy to attract investments to the state, in terms of GDP increase, tax revenue, jobs created, IPM increase and intensification of foreign trade arising from the settlement of new businesses, on the other hand is evident, by analyzing the indicator Human Development Index - IDH - that the expected social development is still under way, although there are a few some individual cases in which the HDI of municipalities has already shown some improvement.

Given this setting, it becomes clear the urgent need for a multilateral effort by federal, state and local governments, which by forgoing their isolated interests, could find a solution that eliminates the negative aspects of the predatory competition experienced today. At the same time, suggesting a federative pact with a healthy level of competition that is able to promote, among other things, the running of public services according to the preferences of the citizens, strengthening of the accountability of politicians, the restriction of tax powers in respect to their ability to extract resources from the private sector and improving the quality, the amount and the access to public services.

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