

2014 Brazil FIFA World Cup & 2016 Rio Olympics: Opportunities to revive Brazilian economy

Aditya Mathur, SPJIMR - Mumbai



INTRODUCTION

Rio +20, UN Conference on Sustainable Development, held during June 2012 in Rio de Janeiro, an event attended by more than 100 heads of state was highly criticized for the lack of organization and poor service. Many delegates suffered hour long traffic delays, and authorities had to intervene after a travel-agency which won the contract to arrange for hotel accommodation of the delegates charged multiple times the usual room rates. Makeshift camps had to be set up in a park due to scarcity of hotel rooms.

The conference brought to surface the appalling state of infrastructure in Rio and other big cities in Brazil. "We won't make the same mistake" promised Mr. Eduardo Paes, Rio's Mayor.

A country which ranks 104 out of 142 countries in the World Economic Forum's survey on Quality of Infrastructure will hold the Football World Cup in 2014, followed by Olympics during 2016.

BRAZIL AND THE 3 WAY DEADLOCK

Brazil is the 6th largest economy by nominal GDP in the world and has seen remarkable growth in last decade backed by large developments in Agriculture, Mining and Manufacturing sectors. Brazil possesses a strong and growing middle class and huge reserves of natural resources.

But the Brazilian economy faces a unique three way

challenge:

- Overvalued currency
- High interest rates
- High inflation

As of October 2012, Brazil's benchmark interest rate was at an all-time low of 7.25% which is still higher than that of most emerging economies. Inflation too has been over 6%. Brazilian Real has doubled in value against dollar in the last decade.

The situation is so delicate that if the government tries to take steps to solve one, then the other would get aggravated. Say, if interest rates are increased to curb inflation then that leads to increased foreign investments and makes the Real more expensive. This would adversely affect exports and trade deficit. Similarly any attempt to make the currency more competitive and increasing exports would require keeping the interest rates low but that would lead to even higher inflation rates.

Brazil has been enjoying substantial growth in recent past on the back of high commodity prices. Such growth, also exhibited by Russia, is not sustainable and can disappear if commodity prices collapse. The GDP growth rate for Brazil in 2008-09 was -0.3% suffering from the global economic meltdown and subsequent fall in commodity prices. Other emerging economies fared much better, with China growing at 9.2%, India at 3.9% and Poland at 1.6% during the same fiscal.

Strong demand for Brazilian products like coffee, steel etc. also drives up the value of Real, making other exports expensive and increasing purchasing power and effecting trade deficit. Inflation in Brazil can be primarily blamed on the poor supply side services.

Brazil today seems to be a costly and an over hyped economy. Restaurants in Sao Paulo are pricier than those in Paris. Apartments in posh localities of Rio cost more than those in prime locations in New York. Local prices are so very high that the visitors from richer nations find Brazil extremely expensive. Clearly something is severely wrong if cities like London and Paris, having PPP adjusted GDP more than 2.5 times that of Rio and 1.5 times that of Sao Paulo, are being found to be more affordable than the Rio and Sao Paulo.

CURIOUS CASE OF BRAZIL

Brazil is seen often in the same light as other major emerging economies like India and China, especially as a part of BRICS Nations. There has been a tendency to compare the decision of Rio to host 2016 Olympics with the 2008 Beijing Olympics with regard to the expenditure and the consequent economic benefits achieved from the event. It becomes important to understand the stark differences between Brazil and China.

China surpassed USA as Brazil's leading trade partner, and this makes them opposite in economic respect. Unlike China and India, Brazil's interest rates are very high, currency overvalued; spending is skewed towards welfare and less towards infrastructure. Productivity grew at 0.2% compared to 4% in China, which shows China has been putting more people to factories and investing heavily in better equipment, better roads, and efficiency. Productivity in India grew at close 3%.

Brazil also suffers from shortage of workers and engineers and a visible decline in manufacturing and services standards. High cost of labor and transport is a direct result of investing too little in infrastructure. China's total investment has increased to 50% of the GDP and Brazil at 19% has one of the lowest rates in emerging world. Spending on new infrastructure, roads, railways, and ports is just 2% of GDP. Poor warehousing and roadways and lack of modern cargo movement facilities are common features of the economy and have been a critical cause of high inflation. Such low investment rates not only lead to inefficiencies but also make the economy extremely vulnerable to high inflation. The supply chain of Brazil is ageing and incompetent to cater to the demands of the economic giant it dreams of becoming. The supply side inflation has been crippling the economy.

Considering the above facts and the three way deadlock, Brazil faces considerable odds in becoming a high growth economic power.

The World Cup and the Olympics provide Brazil the opportunity for getting huge investments and it will be a challenge for the Government to keep interest rates low and currency cheaper. The development of infrastructure in China especially before the Olympics was carried out by the government and huge amounts of funds were put into the purpose without much concern for the finances. The extremely high interest rates in Brazil reduce the attractiveness of private investments in long term infrastructure projects in Brazil.

HOSTING THE MAMMOTH EVENTS

The vigorous competition between nations to host the mega-events like the FIFA World Cup and Olympics is driven primarily by the lure of the vast economic windfall expected which can revitalize host economies. But the huge investments required to support the infrastructure for such events raise the questions of whether the economic benefit outweighs the costs incurred and also the opportunity cost of the investments in setting up sporting infrastructure.

Considering only the financial impact of the games does not provide a balanced view of the overall economic impact of the games. The complete economic impact is seen over several years and can be broadly categorized into three phases: pre-games phase, games phase and post-games phase.

Pre-games Phase: The key benefit that the host nation gains is boost in construction activity. In order to host event of such magnitude it is a must to not only develop world class sporting facilities but also infrastructure to accommodate smooth handling of several tens of thousands people coming to the host nation during those few weeks. This is the phase Brazil is in now. The investment in infrastructure is the key to deliver world class events like these.

Games Phase: Apart from the revenue from the ticket sales, TV rights and other such revenue related to games directly, there are also benefits from the consumption of goods and services of the host nation by the huge volumes of the tourists. The number of tourists for the London Olympics was about 8.8 million and for the South Africa World Cup was over 3 million.

Post-games Phase: Global publicity during the games and the infrastructure development that takes place ensures high tourism for years to come. The boost to international reputation that such huge events provide is also very critical in attracting foreign capital for years to come. Creating international reputation was one of the major reasons for Mexico City, the first Latin American city to host Olympics. These events provide opportunity for emerging economies to make a statement at international level and state their new status as economic giants.

COSTS

A study by the University of Sao Paulo estimated that the infrastructure outlays in Brazil devoted to hosting the 2014 FIFA World Cup and the 2016 Rio Olympics to be approximately \$18b and \$15b respectively, hence the resulting total outlay of \$33b. This is huge for an emerging market economy. Considering that the expenditure for the FIFA World Cup 2010 in South Africa was \$3.5b, over twice the initial estimate and that for the 2004 Athens Olympics was \$15b, over 10 times the initial budget. Taking cue from the past, the actual spend can be expected to be much higher than the planned outlay of \$33b.

As per analyst predictions, indirect investment, such as salaries that return to the economy, the estimate is of approximately \$54b for the FIFA World Cup and \$43b for 2016 Rio Olympics. Of these, 42% of the investment would come from the public sector and 58% from the private.

BENEFITS

For 2008 Beijing Olympics, over a \$1b was invested on transportation projects like developing Beijing's subway system, rail system and construction of hundreds of kilometers of roads in and around the city. A new airport terminal was also constructed. Huge inflows of investment to prepare the nation for the event created a crucial ripple effect on economic growth.

2012 London Olympics are expected to increase economic output until 2015 by approximately \$2b per year and create 17900 jobs every year. The games are expected to provide economic benefit that would constitute not less than 3.5% of the total growth expected in the national economy from 2013 to 2015.

Ministry of Sport, Brazil, claims that 120000 jobs will be created per year by the work being done to prepare the nation for the two mega events. Furthermore, according to University of Sao Paulo, the overall economic impact of the 2016 Rio Olympics is to be over \$50b. As per a study by Ernst & Young, the overall impact of the 2014 FIFA World Cup is to be around \$70b. The overall benefit of over \$120b expected in economic profit from both the events. This figure seems very optimistic and being from different sources may include several overlaps. Nevertheless there would be huge impact on several key sectors of the Brazilian economy.

This investment would mostly cater to pressing need of development of infrastructure in Brazil. Large proportions of the budgeted expenditure are allocated for development of inter-city and intra-city roadways, airports and hotels. As of 2011, a meager 14% of the roads in the entire country are paved.

Tourism is expected to receive a major boost in the entire

Brazil, especially Rio. The number of visitors to Rio is expected to more than double to over 3 billion by 2016. About 12000 new rooms are expected to be completed by 2016 in Rio. Other industries that will, be directly benefited include the construction, electricity and telecommunication industry.

The advantages from hosting events of such magnitude cannot be taken for granted. Historically several host nations have failed to enjoy the dividends of the investing in organization of such events. Japan spent about \$4b for FIFA World Cup 2002, mostly on infrastructure programs but all the spending barely made any positive difference to its sluggish economy. Similarly the number of tourists which were expected in Sydney after it hosted the 2000 Olympics barely saw any change. Other arguments made by the skeptics are that there is almost no long term employment benefits associated with such sporting mega events. Also the large sporting capacity often lies underused and ruinously expensive to maintain, as in the case of 2004 Athens Olympics. Out of the 24 stadia, 21 stadia, arena and other sporting facilities built for the games are mostly in ruins. Also, in months after the games tens of thousands lost jobs in the Greek construction industry.

However this may be very different for Brazil which has huge population and severe backwardness of infrastructure and quality human resource. The measures that will be taken to develop the facilities and services for the events will kick start the much needed growth in spending on infrastructure and will not be contained only till sporting facilities. Development of airports, roadways and ports will ensure employment of huge number of locals not only during construction but also for decades through services offered by these necessities of a powerful economy.

The 2014 FIFA World Cup and the 2016 Rio Olympics demand huge investments in infrastructure in Brazil and will be the drivers of growth and are the best hope Brazilian economy has to break the deadlock of high interest rates, expensive domestic currency and high inflation. With improved, more efficient infrastructure and global acclaim Brazil can be expected to attract a lot more investments not only in the commodity markets but in industries that will provide sustainable growth and holistic development of the Brazilian economy.

CONCLUSION

Brazil could not have expected a better opportunity to invigorate its economic growth. The facilities required for successful conduction of such events will force Brazil to shed all the inertia and invest in developing world class infrastructure to salvage national respect. The mega-events will provide the right platform for Brazil to experiment and break from its low growth trend. The

better infrastructure will help ease the supply side inflation concerns. At the same time lower interest rates and lower tax rates will bring in foreign investments and revive industrial growth.

Brazil needs to take the right lessons from the 1988 Seoul, 1992 Barcelona and the 2008 Beijing Olympics and work towards upgrading the entire urban infrastructure which will reap great dividend for years to come.

The 2014 FIFA World Cup and the 2016 Rio Olympics provide Brazil the opportunity to get benefited broadly in the following 5 ways:

- Revenue
 - Increased tax collection
 - Wealth generation for the region
- Legacy
 - Infrastructure ready for global events
 - Renovation of urban equipment

- Social
 - Large social mobilization and involvement
 - Creation of new jobs
- Intangible
 - Increase in people's self esteem
 - Strengthened regional identities
- Image
 - Increased visibility of the city's brand
 - International exposure

Just as the 1964 Tokyo Olympics, the 1988 Seoul Olympics and the 2008 Beijing Olympics propelled Japan, South Korea and Brazil respectively onto the global stage, the 2014 FIFA World Cup and the 2016 Rio Olympic Games will be Brazil's "coming out" party-an event that showcases Brazil's coming of age as a great economic power.