How can Brazil compete globally?



Kalinka Iaquinto, *Rio de Janeiro*

BRAZIL'S INDUSTRY IS GROWING only marginally, domestic savings are low, GDP projections have been steadily revised downward, inflation and the tax burden remain high, and the qualifications of skilled labor fall short of international standards. Yet unemployment is low and real wages have been rising over the years. This scenario raises questions about how well Brazil can compete in global markets and also meet domestic needs.

These issues were discussed by participants in the seminar on "The Challenges of Competitiveness" sponsored by the Brazilian Institute of Economics of the Getulio Vargas Foundation (IBRE) on June 28, which identified many factors that need to be addressed so that Brazil can be competitive with other countries in terms of productivity, tax burden, and industrial policies.

"In Brazil, we have a policy mix similar to European countries, where countries spend a lot on social programs. We want to be like the Europeans, but we do not have the productivity they have, so in order to spend we tax more," said Mansueto Almeida, economist, Institute of Applied Economic Research (IPEA). This means

that any Brazilian industry that is open to international competition is less competitive. "To support these industries, [the federal government] increases protection," he said. Unfortunately, protecting industry from international competition is a barrier to competitiveness. "We are on the path of failed policies," said IBRE's Maurício Canêdo. "This kind of industrial policy proved inadequate when production chains were contained in countries. If it was inadequate in the 1960s, imagine what will happen with today's global production chains," Almeida said.

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Otaviano Canuto, World Bank senior advisor, pointed out that on one hand global production chains benefit small and low-income countries because they can be inserted into unskilled labor-intensive segments of industry and on the other a country can only make progress in the global production chain by adding value to products, a process that does not happen easily, even in countries with more solid economies like Brazil's. "There must be appropriate infrastructure and regulatory frameworks," he said.

Another hurdle Canuto pointed out is the slow pace at which labor productivity evolves in Brazil. "This is a result of the combination of real wages rising above productivity and soaring industrial labor costs," Canuto said.

In contrast, Samuel Pessôa, IBRE associate researcher, argued that Brazil could look to the Australian model, which combines low domestic savings and high consumption. In an unfavorable industrial setting, the alternative is to bring in foreign savings to pay for imported goods and services. To do this, he explained, the country needs institutions that allow it to live with high current account deficits: sound fiscal policy, a floating exchange rate, free movement of foreign capital, and rules that encourage borrowing from abroad in local currency. Is this possible? Pessôa believes so, but it would require more rigorous institutional discipline. "In this respect in the last five years, we've been going backward," he said.

Slow running

"The economy is working far below its production potential in terms of best practices," said Edmar Bacha, director, Institute for Economic Policy Studies (IEPE); he pointed out that by the end of the 1990s, Brazil was working at only 50% of its capacity in terms of international best productivity practices. "The question is: why are we not there yet?" he asked, and

suggested a way to get there: the focus should be on why Brazil is so much less productive given its factor endowments, stock capital, education, and infrastructure: "For me, the key is competition. We should talk more about the challenges to make this country more competitive."

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In fact, Brazil does not fare well compared to countries with similar incomes and economies. Renato da Fonseca, executive manager of research, National Confederation of Industry (CNI), presented results of a CNI survey that compared 14 countries on eight categories—supply and cost of labor, supply and cost of capital, infrastructure, the tax burden, the economic environment, education, technology, and innovation—and Brazil ended up in 13th position, just ahead of Argentina but below Mexico, Colombia, Russia and South Africa. Da Fonseca noted that macroeconomic stability is not sufficient for growth but it is highly important to bringing in more investment. "Without investment in fixed capital and innovation," he said, "there are no productivity gains."

Another hurdle to investment in Brazil is legal and regulatory uncertainty. José Augusto Fernandes, CNI executive director, said that an excessive number of rules in effect leads to a system without laws. "It leads to increased transaction costs, barriers to investment, legal uncertainty, and the risk of unexpected liabilities," he said. He added that it is necessary to address jurisdictional conflicts between various government spheres, dilatory judicial decisions, the growing role of the judiciary as legislator, the way Brazilian legislation disregards corporate entities, and the excessive power of regulators.

Here, the new ports law is a step in the right direction, according to Eduardo Augusto Guimarães, former Treasury secretary and former IBGE president, because it eliminates some legal uncertainties and will contribute to the resumption of investment in ports. But aside from such specific improvements, the general assessment is that the outlook for Brazil's competitiveness is not bright. "The situation is bad, and the outlook is not good either," summed up Regis Bonelli, organizer of the IBRE seminar.

Urgent need for change

Although viewpoints differed, there was unanimous agreement that reforms need to be carried out quickly, with the government moving promptly to solve problems already identified. "At the end of 2012 concerns about competitiveness and productivity rose—but not enough to impact the [government's] strategy," said Sandra Polónia Rios, director, Center for Integrative

and Development Studies (CINDES).

"There are so many challenges that it is difficult to pinpoint one. We need an institutional apparatus that generates discussion on reforms that are really relevant," said Fernando Veloso, IBRE researcher, illustrating that reforms in the bankruptcy law, personal payroll loans, and the liens law have facilitated and expanded access to credit but have not significantly affected the business environment. "That's the problem," he said. "At some point we have to face the fact that the problem is systemic."

> **"Without investment in fixed capital and innovation, there are no productivity gains."**
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In fact, since 2003 the country has been experiencing a credit boom. The credit-to-GDP ratio increased from about 25% to 55%. However, since 2009 there has been a very significant increase in the share of state-owned banks in total credit. "In 2005, private banks provided about 60% of Brazil's credit . . . . In 2007, this changed and the Treasury has issued public debt to cap-

IN SEARCH OF INNOVATION

THE CONSENSUS IS THAT POLICIES that encourage innovation bring about gains in productivity and competitiveness. Fernanda De Negri, IPEA director of sector studies, believes innovation is a determining factor for the expansion of Brazil's presence in global markets. IPEA data show that innovative firms are 16% more likely to export, generate better jobs, and pay salaries 23% higher than the industry average. Nevertheless, companies still invest too little in innovation. Research and business development expenditure as a share of GDP increased from 0.49% in 2005 to 0.53% in 2008. This negligible increase is just one ten-thousandth of what countries of the Organization for Economic Cooperation and Development (OECD) have invested in the same period.

"If you look at the rest of the world, Brazil is still at the same distance from other countries. Brazil has improved compared to its own past but not in relation to other countries," De Negri said, highlighting the role of the federal Inova Company program that will bring more resources to public policy. However, there is a catch: "Our technology policy is pointing in the right direction, but it will not be effective if other systemic factors are not helping and industrial policy is pointing to less competition and more protection."

A similar scenario can be seen in academic circles. Although Brazil is investing more resources in education, for scientific and technological research it is necessary to take bolder steps. Cláudio Frischtack, president, International Business Consulting (Inter.B), argues for taking academic researchers to companies and reassessing the amount of resources devoted to research. "We have advanced in terms of science, but moved very little in terms of innovation over the years. What is the productivity of resources spent on innovation and science? Our productivity is very low," he said.

italize and strengthen state-owned banks," said IPEA's Almeida. He warned that "Brazil has returned to using state-owned banks as a source of funding." This has not brought about higher growth or increased productivity because to provide funds for state-owned banks to expand their credit operations, there has been a considerable expansion of public debt, which will reduce the government's ability to reduce its interest payments. "Nevertheless, investment remains low and in the short to medium term there is no alternative but to attract foreign savings to grow," he said.

"We managed to worsen what was already a very bad situation, adding new problems", said José Roberto Afonso, IBRE researcher. He believes old distortions need to be changed. For instance, "tax exemptions granted haphazardly resulted in increasing tax spending [through loss of revenues]." What can be done to change this situation? Afonso concluded, "First, we need to update our assessment. Abandon the idea of piecemeal reform without strategic vision and adopt gradual changes more consistently. We must build an entirely new tax system—the current tax system is so bad that it is not worth trying to reform it. New problems arise from the side effects of well-intentioned measures to reform the tax system."

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