

INDUSTRY: Back to the future

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THE ECONOMIC GROWTH of recent years that lifted Brazil to fifth place among world economies has failed to carry manufacturing along with it. Together with external factors, such as the drop in global demand due to slow growth in the United States, Europe, Japan, and China's competition, a combination of domestic factors—the appreciation of the exchange rate starting in 2010, which raised labor costs and hindered exports, the fall in productivity, and continuing problems of competitiveness—prevented Brazilian industry from expanding with the rest of the economy.

Average growth of manufacturing in the last decade did not reach 3%. “Between 1996 and 2003, Brazilian manufacturing export volumes grew by 8.4% on average, compared with 0.8% for imports but between 2003 and 2010 manufacturing export volumes increased only 4.4%, versus 13.1% for imports,” Aloisio Campelo Jr., assistant superintendent of the IBRE/FGV Business Cycle, said by way of illustration. The cost of labor in foreign currency was 21% higher in 2004–10 than in 1996–2002.

Productivity, measured using national accounts data, declined 0.8% a year in manufacturing for 2000–09, while it increased by 4.3% annually in agriculture and 0.5% in services.

However, the government strategy for addressing the lack of competitiveness of industry also raises concerns. Adoption of mechanisms to defend domestic industry—preferential tax treatment,

and legal requirements to hire and buy parts locally—could eventually make domestic industry even less productive and competitive, undermine public finances, and aggravate income disparities.

“The problem with protectionist policies is that, after passing the critical period, it is hard to eliminate them. Although

the authorities talk about innovating to grow . . . these policies may generate few results,” says IBRE researcher Mauricio Canêdo. The protectionist policies carried out since the 2008 crisis and continued in the Greater Brazil Plan in late 2011 have also had an effect on the government budget. “Today we have fiscal tightening due to both low growth and the tax exemptions, and we cannot meet the primary budget surplus target without using accounting



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gimmicks, like anticipating the payment of dividends by state-owned companies,” says Regis Bonelli, coordinator of the IBRE Economic Outlook.

This deteriorating trend in public finances, according to Pedro Cavalcanti, professor of economics, FGV Graduate School in Economics (EPGE / FGV), has intensified since 2005. “Between 1995 and 2005, both the Cardoso and the Lula administrations undertook a series of economic reforms: privatization of public utilities, creation of regulatory agencies, the Fiscal Responsibility Law, and a successful macroeconomic regime. The Lula administration reformed social security pensions and passed a new bankruptcy law There was an understanding that the government does not need to produce but rather to be a regulator,” he recalls. With the chaos of the 2008 crisis, this reform agenda was abandoned. The crisis was used as an excuse to reintroduce a vision of the state role in the economy that had prevailed in the 1970s. It had guaranteed growth for a number of years but has generated a series of distortions that ultimately hindered growth, Cavalcanti explains. “The policies adopted are a guide for how to reduce productivity: an industrial policy subsidized by massive transfers from the Treasury to the National Bank

for Economic and Social Development (BNDES) . . . without performance goals and timeframes,” he says.

USE IN MODERATION

“When we look at the experience of other countries and economic theory, we find that industrial policies to be successful should be used sparingly: they should have clear targets, a definite date to end, and protection should decline over time,” Canêdo says. “Industrial policy is not a substitute for [dealing with] infrastructure

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problems, red tape for doing business, and an inefficient tax system. Reforms are always more efficient,” he says. Cavalcanti argues that “the rapid growth that occurred between 1968 and 1973 (the economic ‘miracle’) resulted from economic and institutional reforms implemented between 1965 and 1967 by the Economic Action Plan

of the Government during the Castello Branco administration.”

IBRE researchers also point out that the concern about the relative loss of importance of industry since trade and foreign competition opened up in the 1990s should be considered in the context of structural transformation of countries. “When the economy grows, the proportional size of industry tends to decrease because people’s needs and

demand shift to travel, education, etc. There is no doubt that we are moving to a model like the U.S., where services represent 80% of the economy," says Cavalcanti.

In Brazil, the share of the manufacturing sector in the economy peaked at 23% of GDP in 1974–1976, and had fallen to 16% by 2009–11. Elsewhere, the 2010 average was 10% of GDP for countries in the Organization for Economic Cooperation and Development (OECD) and 16% in Central Europe. "Today, more thinking in terms of a thriving industry, we should focus on policies to make the service sector more productive because our workforce is less skilled," Cavalcanti said.

For Bonelli, Brazilian industry should have better days in the near future because domestic consumption remains buoyant and the almost 20% exchange rate devaluation improves prospects for manufactured exports. "We see an increase in confidence in industry, but there are still uncertainties, because it is boosted by exceptional measures and

a strong domestic consumer market, and we do not know what will happen when this is over," Campelo says. "We need to focus on policies to increase productivity and competitiveness, especially those that encourage more and better spending on education and training."

The key question, however, is the quality of these policies and government ability to carry them out. For instance, "On the

one hand, the government was right to seek a reduction in the electricity price, a key input for the industry. But this brought about insecurity [in the power sector]," says Campelo. The government's concessions program for transport infrastructure raises similar concern: "We need a pragmatic government that corrects its course when necessary."

"With clear rules and few barriers and without changing rules

of private contracts halfway through the game, incentives to invest in technology and innovation will be better than protecting industry from competition," Cavalcanti concludes. ■

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