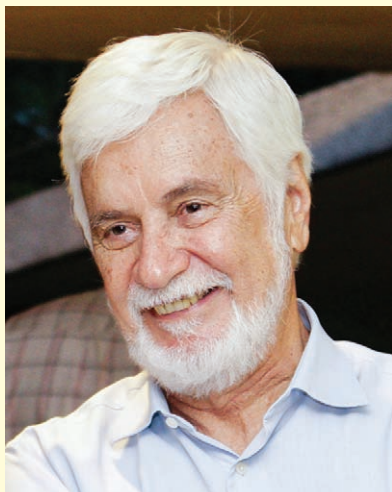


Protectionism is bad for growth



Edmar Bacha

Member, Business Cycle Dating Committee

Claudio Accioli, *Rio de Janeiro*

With exhaustion of the boom of rising commodity prices and labor surpluses that gave it a small economic miracle between 2005 and 2010, the Brazilian economy now faces a harsh new reality, in which growth can only be achieved if there is more investment and higher productivity. But the government's difficulties in carrying out public investments and the rules for hiring and buying parts locally can undermine investment and growth. So warns Edmar Bacha, the former president of the Brazilian Institute of Geography and Statistics (IBGE) and member of the Business Cycle Dating Committee of the Brazilian Institute of Economics (Codace IBRE). He is finishing a book on deindustrialization in Brazil. "We are . . . closing the country to the world, which is absurd. We will not ever grow, because the government has no capacity to invest and prevents the private sector from buying better technology and more productive assets from elsewhere in the world," he says. To boost industry, Bacha advocates a radical program that would double the share of foreign trade in GDP and halve the tax burden on companies, regardless of sector: "That would be a genuine industrial policy!"

The Brazilian Economy—The government has lowered interest rates, granted tax exemptions for certain industries, and announced packages of investments, but Brazil's GDP growth rate was only a disappointing 0.6% in the third quarter and may be less than 1% for the year. **Why is the economy not taking off?**

Edmar Bacha—I think this is the end of the growth cycle that we had between 2005 and 2010, followed by two years of very low GDP and investment. In the first period, there was a very specific combination of good things that produced a small "growth miracle," but now a new reality is knocking at our door.

What would this reality be?

In 2005, investment was very low, which meant there was huge room for recovery. In fact, that's what happened: Investment increased from 15.5% of GDP in 2004 to 19.5% in 2010—in my view, in large part because of a huge external bonanza in terms of both higher prices for our exports and abundant external financing . . . We also had a high unemployment rate in 2004, about 12%, which came down to just 5.3% in October 2012 . . . Now, the boom has ended, commodity prices have

stabilized or are falling, the availability of external financing has declined, and the labor surplus has disappeared Brazil's sustainable growth pattern today is different from the growth cycle in 2005–2010. Growth now will depend heavily on investment and productivity.

But investment has declined for five consecutive quarters. How do we revive it?

The main problem is the current government's interventionist bias, but it is also unable to execute planned investments that have been budgeted. The government makes one announcement after another promising to invest, but nothing materializes. Even President Rousseff, in a recent interview, admitted the problem is not money but execution. The delays have been due to a number of factors, such as uncovering corruption in public works that paralyzed investment in transport, unqualified people in key positions, public procurement laws, a dilatory Court of Audit, and problems getting environmental permits. The whole system is poorly articulated and badly managed. Given these difficulties, one would expect that the federal government was willing, as many state and local governments are doing, to call on the private sector to carry out infrastructure works. The government does call on the private sector, but everything goes slowly and, when a plan finally comes, it is inadequate — as has been dramatically illustrated in the case of airports.

Now the government has announced measures for ports but does not dare to touch the state-owned dock company The entire process is entirely lethargic. Similarly, changes in the rules of the game interfere in decisions, discouraging some and encouraging others who have privileged access to the National Bank for Economic and Social Development.

What about productivity?

The primary reason [for low productivity] is the fact that our economy is one of the most closed in the world. In the rankings of the World Bank and Penn World Tables, we are the 169th economy with the lowest share of foreign trade in GDP. This deprives us of imported products that would add productivity and creates domestic monopolies and oligopolies that are not favorable to productivity growth, because there is no innovation without competition. The current highly protectionist policy goes totally against what the country needs to increase productivity, which is to integrate competitively into international trade flows.

Traditionally Brazil also has low domestic savings. To what extent does this affect performance of the economy?

It would be good to save more. But the bigger problem is that prices of capital goods in Brazil are very high in interna-

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tional terms. So . . . we have to acquire capital goods produced locally at prices much higher than if the economy was exposed to more international competition.

IBRE estimates potential GDP growth of between 3% and 3.5%. Which sectors should be prioritized to increase growth?

It all starts with infrastructure [which] provides the logistics of ports, airports, and roads. And that is going badly, for the reasons I mentioned. The government should focus its action on providing good infrastructure for the country and let the private sector compete for the rest.

You are editing a book on deindustrialization in Brazil. Since industry has been replaced in GDP by the service sector worldwide, what is unique to our local reality?

The share of this or that sector in GDP depends on specific situations related to history, geography, the economy, and consumer preference. The problem is not the share of industry in GDP, but its quality. In Brazil, the government wants to produce all parts for all products, adopting an import-substitution industrial policy. For example, the new policy for the health sector the Ministry of Health has proposed is to reduce to zero the trade deficit of US\$11 billion of medicines and hospital equipment by decreasing

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imports. For this, the government proposes to pay 25% more to those who produce these items in Brazil This model extends to other sectors, such as exploitation of deep-sea oil and the automobile industry, in which if companies meet the government’s requirements they are protected by a 70% tariff. Our policy has become to close the country to the world,

which is absurd. We will never grow, because the government has no capacity to invest and is preventing the private sector from accessing better technology and more productive assets from elsewhere in the world.

What are your views on the government’s recent measures to grant relief to some industry sectors in an attempt to boost growth?

I find it absurd to select who will receive this or that favor. I would advocate a radical program to redefine Brazilian industry with two basic measures: double the share of foreign trade in GDP, from 12% to 25%, and halve the tax burden on businesses, from 60% to 30%. That would be a genuine industrial policy, with the goal of raising productivity to make the Brazilian economy grow.

Besides growth being low, inflation is high because of services inflation. Is this worrying?

Yes, the combination of high inflation and low growth is very worrying because it shows that the Brazilian economy has a disease Fundamentally, what is at issue here is low productivity. When productivity is low, in theory it is possible to have full employment with zero growth Growth and expansion of employment was led by commodities exports, which generated growth of services and construction—more labor-intensive sectors.

The international crisis is far from ending. How could it affect Brazil in 2013?


The international situation is bad, but it appears the risk is decreasing. News from Europe is not so bad, with the search for solutions to Greece. In the United States, employment is a little better. Probably external factors will not help [Brazil]—there will be no new commodity boom or abundant external

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financing—but they also will not hurt. Our risk is not a new large international financial crisis but a continuation of our domestic problems. That is the cause of our low growth and high inflation, which compare poorly to our Latin American neighbors.

What do you expect for the Brazilian economy in

the next year?

Growth will have to recover to some extent because it is hard to imagine it will be as bad as 2012. I expect GDP to grow between 3% and 3.5%. Inflation should decline, benefitting from moderate food prices and the government policy of controlling energy prices. If it continues controlling gasoline prices, it is possible to create conditions for slightly higher growth, keeping inflation at current levels. The scenario will be a bit better than this year, but nothing that will do justice to the potential of our country. 

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