

Paths to industry transformation

Experts debate how Brazilian industry can regain the momentum it has lost in recent years.

Solange Monteiro

BRAZILIAN MANUFACTURING seems to have run aground. From 2003 to 2013, manufacturing lost 6 percentage points in its share in gross domestic product (GDP). According to data from the Federation of Industries of São Paulo (Fiesp), since 2003 industrial production has grown by only 25% while retail trade volume grew 117%. In 2013 the external trade deficit reached a record high of US$54.5 billion, and imported manufactures have doubled their share in the domestic market in the last decade. There are many reasons for the decline of domestic industry: the effects of the 2008 global economic crisis, loss of competitiveness due to such factors as an over-valued exchange rate, poor-quality infrastructure, and the well-known Brazil cost. So what can be done?

To discuss possible ways manufacturing might recover, the School of Economics of São Paulo (EESP) and the Brazilian Institute of Economics (IBRE) of the Getulio Vargas Foundation held a seminar on "Industry and Production Development in Brazil" May 26–27 in São Paulo. In launching the seminar EESP's Nelson Marconi pointed out that the loss of manufacturing's share in Brazilian GDP was premature in terms of the global historical pattern: in developed countries the turning point had come when per capita income reached US$10,000; in Brazil it happened when per capita income reached

US$4,000. IBRE director Luiz Guilherme Schymura commented that "The drop in industrial activity has been accentuated since 2010, and this year, we are still seeing a decline in industry confidence. Maybe today's 11% of GDP is the new industry share in the economy." If so, he said, that would have important implications for the formulation of economic policy.

The move to services

Experts are also concerned with the new distribution of GDP. In Brazil, part of industry's share in the economy was lost to the service sector, which in Brazil has low productivity and little added value; in more competitive economies high-skilled services that support industrial activity predominate. EESP director Yoshiaki Nakano noted that the rise of global supply chains has rendered provision of technological services vital for industry success. "In Brazil, however, political populism has kept the exchange rate overvalued and raised wages, generating expansion of income and employment through service sector growth," he explained. He mourned the lack of an overall strategy for inserting the country effectively into the global economy, saying "It takes political will and pragmatic vision to boost productivity."

David Kupfer of the Federal University of Rio de Janeiro (UFRJ) pointed out that delivery of services adds value to the products provided. It involves such product-related activities as research, planning, marketing, distribution, and after-sale services. "From the point of view of integration of the country's trade into the global economy," he said, "it implies organizational and technological change that puts more intangibles into industry output."

Francisco Eduardo Pires de Souza, also of UFRJ, was of the opinion that "As we are close to full employment and the workforce is expected to grow more slowly, economic growth will depend even more on increased productivity." He noted that despite low growth, industry still has higher productivity than services, and said, "That is why industry is essential to pull more dynamic services, which in turn will improve productivity and boost the growth of industry."

Global aim

Cristina Reis of the Federal University of ABC (UFABC), pointed out that promoting the trend to services involves integrating economic and industrial policies with trade liberalization. EESP's Lucas Ferraz added that trade in intermediate goods goes through global supply chains that today are much broader in both length and value-added; they "demand investments to improve transport infrastructure, trade facilitation, and training of workers, as well as a good business environment."

The prospects for such investments do not look promising. Brazil is among the most closed economies in the world and among those that use the most domestic intermediate inputs. "In China 61% of the value of an exported product is national. In Brazil it is about 87%," Ferraz said. If at first glance this seems to show that most wealth is generated in the country, it also indicates the low diversity and dynamism of local industry, which is also demonstrated by the fact that most imported manufactures are technology-intensive. According to IBRE's Lia Valls, the low technological content in Brazilian manufactures is reflected in Brazil's small share in total world manufactures exports: only 0.7% since 2009.

Could more integration of domestic industry into global supply chains help motivate Brazil to streamline negotiation of trade agreements? According to Valls, "It is not clear that institutional arrangements ensure insertion in global supply chains or productivity gains if they do not promote a favorable environment for market integration."

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She believes the Brazilian trade agenda should focus on efforts to promote Latin American integration and reconsider membership in mega-trade deals. However, she said, "The priority must be on domestic reforms."

Economic adjustment

Valls is convinced that any strategy for liberalizing trade will require that Brazil relieve the internal obstacles to improve industry's external competitiveness. Otaviano Canuto of the World Bank added that, "Brazil is one of the worst in the world in terms of cost of doing business. There is a lack of competition and pervasive waste. Total factor productivity could have been much higher if we had not wasted resources on low-value activities."

IBRE's Samuel Pessôa emphasized the effects on industry of low domestic savings. "In an economy that saves little," he said, "industry has a hard life because the economy will consume many services." He estimated that "The difference in savings between Brazil and China is about 30%. If Brazil had domestic savings like China's, industry's participation in GDP would be 10% higher."

For EESP's Nakano, the crux of the issue is a familiar trio: high interest rates, an appreciated exchange rate, and high taxes; he noted that "Any stimulus policy only compensates in part for … these factors." EESP professor and former finance minister Luiz Carlos Bresser Pereira argued that exchange rate populism and economic orthodoxy have led Brazil to allow the exchange rate to further appreciate and use high interest rates to achieve its inflation target—he called this "a profound disaster."

José Luis Oreiro of UFRJ pointed out that the overvaluation that occurred between 2005 and 2010 was only partially reversed, and the reduction of interest rates was transitory. IBRE's Nelson Barbosa agreed: "As for the interest rate, the important thing is to maintain the government primary balance surplus to reduce gross debt and maintain economic stability without raising interest rates, keeping inflation on target." Barbosa spoke for fiscal adjustment to achieve a permanent primary balance surplus and resisting the temptation to manage the exchange rate. In sum, he said, "In recent months, the central bank tried to avoid excessive exchange rate depreciation by selling foreign currency swaps. This did reduce short-term volatility, but it prevented the exchange rate adjustment necessary to restore external competitiveness and reduce the current account deficit."

Industrial policy pro and con

Seminar panelists pointed out that macroeconomic distortions have not only affected industry but also undermined the effectiveness of industrial policy itself. In the last decade, the industry relied on three government initiatives: the Industrial, Technological and Foreign Trade Policy (PITCE, 2004), the Productive Development Policy (PDP, 2008), and the Greater Brazil Plan (PBM, 2011). None has been able to prevent the slide in manufacturing as a share of GDP. "It is difficult to quantify the outcome of the

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Greater Brazil Plan because the period was short and implementation gradual," said Renato Corona Fernandes, manager of the Fiesp Department of Competitiveness and Technology. "Our research found that between 2008 and 2012, the Brazil cost and the overvaluation of the Brazilian currency raised the cost of manufacturing production on average by 34.6%." IBRE's Regis Bonelli pointed out that until 2012 manufacturing productivity was rising: "It grew less than in the United States, which is considered the world frontier for labor productivity, but it has continued to increase. This suggests that the competitiveness problems have not been inside the factory."

Most analysts, however, argue that industry's problems could have been even worse without industrial policies. "The tax exemptions represented relief against the overvalued exchange rate and a tax system that discourages local production compared to imported," said Marcelo Miterhof of the National Development Bank (BNDES). IBRE's Barbosa said that the package of measures for supporting industry was able to stabilize investment: "GDP growth slowed, but investment has been more or less stable since 2010. This means that incentive policies like reducing the tax on industrial products helped to lower the relative prices of capital goods."

Some experts reiterated, however, that despite macroeconomic distortions the current model of industrial policy is not without flaws. Mauricio Canêdo of IBRE stressed that "An industrial policy cannot be aimed at developing industries at any cost. If the goals and duration are not well-defined, there is a risk of developing noncompetitive industrial sectors."

Mansueto Almeida of the Institute of Applied Economic Research (IPEA) also advocated more transparent controls and a reevaluation of policies. He also considered subsidized credit operations excessive because in the current scenario Brazil cannot afford them: "Today, the low level of domestic saving and the large social programs do not leave much fiscal space for the costs of a robust industrial policy. In the early 1970s when public savings accounted for 6% of GDP, we could do it. At that time, we invested 2.5% of GDP in education and 3.5% of GDP in social security. Today social spending accounts for 23.5% of GDP. We cannot afford both social and industrial policies at the same time." He also condemned the expansion of public debt by 10% of GDP to subsidize lending by public banks.

Innovation in focus

IBRE's Canêdo warned that protectionist bias in industrial policy hampers innovation and competitiveness: "We have a well-designed innovation policy but . . . no one innovates by chance. Companies protected from competition will not be pressed to invest in technology to improve productivity."

One federal initiative praised by the experts is Inova Enterprise, launched in 2013. The program's goal is to contract US$14 billion in 2014 to promote product creation in strategic areas of national interest or potential demand. "By March, BNDES had selected 331 company plans, totaling US$11 billion," said Miterhof. Nine plans are already underway in ethanol (2), oil and gas, energy, defense and aerospace, telecommunications, agribusiness, health, and environmental sustainability. João de Negri, executive secretary, Ministry of Science, Technology and Innovation, points out that "The program also involves partnerships between companies and research institutes, which promotes the formation of consortia."

Mariano Laplane of the State University of Campinas believes that one problem with industrial policies and innovation in Brazil is lack of a culture of innovation, which can be stimulated through greater cooperation. José Eduardo Cassiolato of UFRJ agreed, pointing out that "The trend of increasing intangible assets in industrial production —such as software, scientific research, design, and product development—demands a more integrated world."

Prices of Brazilian manufactures are higher compared with imported manufactures from trading partners:

34% Trading partners*

31% Developed countries

38% Emerging countries

35% China

* Argentina, Canada, Chile, China, South Korea, Spain, USA, France, India, Italy, Japan, Mexico, United Kingdom and Switzerland.

Source: Federation of Industries of São Paulo (Fiesp

