International Institutions
Will the new BRICS institutions make a difference?

The 2014 Elections
More questions than usual

Interview
Angel Gurría
OECD Secretary-General



THE BRAZILIAN ECONOMY

FGV IBRE A publication of the Getulio Vargas Foundation • August 2014 • vol. 6 • nº 8

CAN BRAZIL FIND A ROUTE TO COMPETITIVENESS?

If it is to join up with global supply chains, Brazil must confront old problems that inhibit the competitiveness of its industry

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THE BRAZILIAN ECONOMY

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Two very similar parties have controlled Brazil's last five presidential elections, and one of them will probably win again this year. But, says João Augusto de Castro Neves, a new element is likely to make this year's election a bit different, and more competitive, than previous races. That is the new middle class, whose street protests suggest diffuse discontent with the established parties.

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Professor Riordan Roett also sees uncertainty about the course of the election; he thinks "The discontent over the money spent on the World Cup should play in favor of the opposition, "but asks whether that will be as relevant in October as it was in July." He notes that across the region democratic politics are being questioned by more and more citizens, and predicts that the October election will be a cliff hanger.

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Brazil is still behind the curve in terms of integration into global value chains. If it is to become a valuable link in such chains, it must confront old problems that inhibit the competitiveness of its industry. Solange Monteiro identifies how Brazil lost out on the global value chain trend, looks at what some other countries have been doing, and asks the experts what Brazil could do to catch up and what hurdles Brazil faces in getting back on track. There seems to be a general consensus on the need for a fresh look at trade policy generally.

Interview



20 Brazil: Making progress but still far to go
As Secretary-General of the Organization for Economic Cooperation and Development (OECD) since 2006, Angel Gurría of Mexico has reinforced the OECD's role as a hub for global debate on economic policy issues. In an interview with Solange Monteiro he calls for developing countries like Brazil to speed up structural reforms and argues for investment in policies that boost productivity and competitiveness to lead the country to more balanced growth.

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26 Will the new BRICS institutions make a difference?
In July in Fortaleza, the BRICS countries announced the establishment of a BRICS development bank and an agreement to pool currency reserves. Lia Valls Pereira analyzes the implications of these decisions in the light of studies recently issued and considers how political and economic asymmetries between BRICS members might create difficulties for such joint projects.

ECONOMY

Fewest jobs created since 1998

In June 25,363 jobs were created, down 56.9% from last year and the worst result for June since 1998, according to the Ministry of Labor. For the entire first half, 588,761 jobs were created, the least since 2009. (July 17)

Growth forecast lowered

Private forecasters have reduced their GDP forecasts to 0.97% for 2014, down from about 1.6% two months ago, but still expect inflation to end 2014 near the Central Bank's 6.5% target ceiling. (July 22)

Electricity bills may surge

Electricity rates may rise by up to 8 percentage points starting in 2015 so electricity distributors can offset the rise in their costs due to prolonged drought, says the National Electric Energy Agency (ANEEL). As yet there are no projections for consumer rates, but the costs to businesses are estimated at US$17.7 billion. (July 29)

July trade balance surplus was US$1.6 billion

The Brazilian trade surplus reached US$1.6 billion in July, the Ministry of Development, Industry and Trade announced. For the year, however, the trade balance shows a deficit of US$916 million. (August 1)

Vehicle sales fall 13.9% in July

The National Federation of Car Dealers reported that vehicle sales were 13.9% lower this July than in 2013. In both June and July the World Cup reduced dealer's sales. For the year sales have fallen 8.6%. (August 1)

Inflation slows

The Consumer Price Index rose 0.01% in July, down from 0.40% in June, said government statistics agency IBGE; 12-month inflation ending in July was 6.5%, the ceiling of the Central Bank inflation target range. Transport prices declined noticeably, though services inflation is still high. (August 8)

Petrobras: Second quarter profits down

State-owned oil company Petrobras ended the second quarter with a profit of US$4.96 billion, down 20% from 2013. Operating profit, before interest, taxes, depreciation and amortization, fell 10.2% to US$16.25 billion, influenced by controlled domestic fuel prices that are lower than international prices. Revenue, however, increased by 11.8%, to R$82.30 billion. (August 8)

INTERNATIONAL FINANCE



Photo: Marcelo Camargo/Agencia Brasil.

Russian President Vladimir Putin, Indian Prime Minister Narendra Modi, President Rousseff, Chinese President Xi Jinping, and South African President Jacob Zuma at the BRICS 6th Summit.

BRICS launch a development bank

Brazil, China, Russia, India and South Africa unveiled the new bank at the BRICS summit in Fortaleza. It will be headquartered in Shanghai. The bloc also agreed to release US$50 billion to finance infrastructure in BRICS and other developing nations. India will take up the development bank presidency. President Dilma Rousseff said that the institution will not affect Brazilian participation in such multilateral institutions as the International Monetary Fund (IMF), but also said that the IMF does not reflect the current global balance of power. (July 16)

2014 ELECTIONS

Datafolha: Rousseff and Neves would tie in a run-off

With a current rating of 36%, President Dilma Rousseff (Worker's Party, PT) still leads in polls for the coming presidential elections, but for the first time, senator Aécio Neves (Brazilian Social Democratic Party, PSDB) could tie with her if the elections go to a second round. According to Datafolha, if the two were to face off today, Rousseff would collect 44% of the votes and Neves 40%. With a two point margin of error, the two are virtually tied. (July 17)

Presidential candidates square off at CNI Q&A

The current government will leave "the worst fiscal situation in decades" and "the poor results of the Brazilian economy are the result of wrong policy choices" by the current administration, said PSDB candidate Aécio Neves at a National Confederation of Industry (CNI) Q & A. Neves also criticized current Brazilian foreign policy and argued that "Brazil needs greater trade with the developed world. … I will realign our foreign policy with a non-ideological trade agenda, resuming negotiations with other regions."



Photo: Antonio Cruz/Agencia Brasil.

Presidential candidates, former Pernambuco Governor Eduardo Campos (PSB), President Dilma Rousseff (PT), and Senator Aécio Neves (PSDB).

The Brazilian Socialist Party (PSB) candidate for president, former Pernambuco Governor Eduardo Campos said that active social inclusion policies are also an economic policy. Campos also said that although he respected his opponents, President Dilma Rousseff (PT) and Senator Neves (PSDB), "The circumstances surrounding President Rousseff and Senator Neves are to preserve this old politics that has failed."

However, President Rousseff, the Workers' Party (PT) candidate, criticized those who believe that Brazil's industrial policy is a mistake and "those who conspire openly or shamefacedly, against the public funding of the National Bank for Economic and Social Development (BNDES)." She reiterated that if re-elected, she will give priority to tax reform and promised to "improve the business environment" and seek "new institutional measures" to ensure investment. (July 30)

ECONOMIC POLICY

Policy rate unchanged despite high inflation

In the minutes of the most recent meeting of the central bank Monetary Policy Committee (Copom), the bank pledged to remain vigilant in controlling inflation as it again kept its policy rate at 11%. Copom issued its customarily brief statement: "Taking into account the progress of the macroeconomic scenario and the inflation outlook, the Copom decided unanimously, at this moment, to keep the policy rate at 11% a year, without bias."

It appears that for now the central bank has ruled out slashing borrowing costs: "The committee anticipates an outlook of resistant inflation in coming quarters, but keeping monetary conditions stable … tends to get [inflation] on the path of convergence toward the goal." (July 16 and 24)



Photo: Antonio Cruz/Agencia Brasil

Central bank Governor Tombini

June primary budget deficit: US$930 million

Brazil's public sector posted a primary budget deficit of R$2.1 billion (US$930 million) in June, the central bank said. The primary surplus in the 12 months through June narrowed to R$68.5 billion, 1.36% of GDP, from R$76.1 billion, 1.52% in May. The government's 2014 target for the primary surplus (the budget balance excluding interest payments) is 1.9% of GDP. (July 30)

Tombini sees less growth

After expansion stalled in the first half of 2014, Brazil's economy will probably recover in the second half, central bank chief Alexandre Tombini said, though it will likely grow less this year than last. Tombini told the Senate economic affairs committee that there is no contradiction between monetary policy and recent macroprudential measures to improve banking system liquidity. He reiterated that the bank is not considering reducing its policy interest rate in the near future despite the economic slowdown. "We certainly cannot speak of a crisis," he said. "I want inflation to be lower than it is now, but it is under control." Still, Tombini acknowledged a risk that the Brazilian industrial sector could contract in 2014. (August 5)

FGV Brazil

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FGV

Can Brazil become truly competitive globally?

IN RECENT YEARS, THE PRODUCTIVE effect of a country's integration into international trade, joining global value chains, has become clear. In 2011, imports of raw materials and intermediate components for the manufacture of products to be exported represented over 60% of global trade. An important—and related—trend is the increasing share of services, which now account for more than 42% of world trade. The consolidation of global value chains has brought into focus the challenge they create for Brazil's global competitiveness and its negotiation of new trade agreements. Although this may seem to set a new agenda for Brazil, in fact it requires that the country address its old agenda of long-standing structural weaknesses and ambivalence about opening up the economy.

According to Angel Gurría, the OECD secretary-general, the recent global trade slowdown has exposed structural weaknesses in the supply side of Brazil's economy that were concealed by the commodity boom. Among these are a fragile manufacturing sector and too little investment and savings relative to GDP. To attract investment—as is necessary to raise output growth and productivity—Brazil must eliminate such structural constraints as infrastructure deficiencies, high labor costs, shortage of skilled workers, a high tax burden and an onerous tax system, excessive administrative burdens, and shallow credit markets, as well as more direct barriers to international trade.

Gurría criticizes the protection that some Brazilian productive sectors still receive; protection discourages investments in research and development and in training the workforce in areas that would enhance their productivity and enable domestic industry to better face foreign competition.

The consolidation of global value chains has brought into focus the challenge they create for Brazil's global competitiveness.

As the continuing deterioration of its trade balance portends, the opportunity cost of Brazil's lack of a proactive trade agenda will surely increase, and Mercosur, the region's largest trade bloc, is still beleaguered by disputes among its member states and outright violations of its rules that prevent it from flourishing as a free-trade area. There is also the risk that major trade initiatives like the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership may sideline WTO negotiations and split Mercosur.

How willing are this year's presidential candidates to confront these issues? Regardless of who wins, the next government will surely have to make changes in trade policy. A more challenging domestic and international economic environment should press the new administration to adopt a more pragmatic trade policy and work to seek closer economic ties with all major trading partners. Yet to do that will require Brazil to rethink Mercosur's role as a customs union, conclude trade agreement negotiations with the EU, and kick-start more productive trade talks with the US.

Any hope of domestic reforms to raise output growth and productivity will be influenced by what the candidates say and do in response to the expectations of the tens of millions of Brazilians who have moved into the lower middle class. How the political coalitions that are consolidating during the campaign react deserves close observation—not just to identify the network of individual supporters for each candidate but also to measure how much support from Congress the elected president will have to carry out the necessary new programs successfully.

Could a third path open up?

João Augusto de Castro Neves

TWO PARTIES HAVE CONTROLLED Brazil's last five presidential elections. For nearly two decades, the Brazilian Social Democracy Party (PSDB) and the Workers' Party (PT) have dominated the national political landscape, with two victories for the PSDB (1994 and 1998) and three for the PT (2002, 2006, and 2010). With President Dilma Rousseff (PT) and Senator Aécio Neves (PSDB) leading the polls less than three months away from the election, the polarization seems likely to endure through yet another political cycle.

However, there have been recurrent attempts to break up the duality. In years when the incumbent is running, these attempts have been noticeably fruitless. In 1998, former governor Ciro Gomes got only 11% of the votes and in 2006 former senator Heloisa Helena grabbed a meager 7%. In years without an incumbent, the presidential race tends to be more competitive. In 2002, former governor Anthony Garotinho reached 18% (Gomes also ran that year, receiving 12%; he had peaked in pre-election polling at 27% only to implode a few months before the ballot). In 2010, former minister Marina Silva achieved 19% of the votes—until now the best performance by a third-party candidate.

For nearly two decades, the Brazilian Social Democracy Party (PSDB) and the Workers' Party (PT) have dominated the national political landscape.

What about the 2014 election? The comments just made may suggest that there won't be much room for a third candidate: Not only is there an incumbent running but also polls have been consistently showing the usual tension between the PT's Rousseff and the PSDB's Neves. In fact, after formally announcing his candidacy in April, in May former governor Eduardo Campos of Brazil's Socialist Party (PSB) did attract 11% of those intending to vote but has since been struggling in the single digits. Nevertheless, despite the poor performance so far, Campos is likely to go up in the polls when the campaign starts in earnest, mainly because his running mate is Marina Silva, who did relatively well in 2010.

Even if unlikely to smash through the PT-PSDB polarization in October, the Campos candidacy could represent an inflexion point for a more competitive political landscape in the future. Silva's impressive performance in 2010 was already a sign of voter fatigue with the two mainstream parties. As a former member of the PT and a candidate of the Green Party (PV), she

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was able to garner a broad range of support from environmentalists, evangelicals, leftwing movements frustrated with the PT, and the antiestablishment vote. In fact, the heterogeneity of her support helps explain why Campos hasn't automatically inherited those votes, and probably will pick up only a portion of them.

Until now, voter fatigue with the PT and the PSDB hasn't translated into a viable third alternative. This may have to do with the fact that the PT-PSDB divide is more about competition for power than contrast of ideologies. To an extent, the overlap in ideologies tends to somewhat constrict the political debate. Despite heated rhetoric between the two parties and accusations that gain in intensity during election campaigns, with a few exceptions the differences in approach to most policies are mere nuances. Broadly speaking, the PT and the PSDB aren't that far apart; both are vying for the center-left side of the political spectrum. In fact, the lack of major political parties espousing more conservative ideas tilts Brazil's entire political spectrum to the left, overcrowding the debate with generally like-minded voices.

Against this backdrop, it would be difficult to drive a wedge between the PT and the PSDB by resorting to messages and political arrangements similar to theirs. Most-third party candidates so far have been defectors from one of those two parties, which dampens any expectations that they will bring a fresh alternative to the table. Campos and Silva face a similar challenge this year. Rather than exploring new issues and approaches—which may eventually move them across the political spectrum but heighten the risk to their candidacy—they have been attempting to bridge the divide between the PT and the PSDB without cutting the cord completely. Such a strategy may be very useful in a second round run-off against either the PSDB or the PT, but hedging doesn't give them enough momentum to catapult Campos past the first ballot.

Campos's hope lies in a new element that is likely to make this year's election a bit different—and more competitive—than previous races. That is the new middle class.

Nevertheless, Campos's hope lies in a new element that is likely to make this year's election a bit different, and more competitive, than previous races. That is the new middle class. The wave of protests for better public services that rocked major Brazilian cities last year churned up diffuse discontent with the established parties. So far, this malaise has produced impatience, and this year that may merely lead to political apathy: there is a risk that the large number of undecided voters will translate to record-low voter turnout in October. While constrained by fewer campaign resources than the PT and the PSDB, Campos and Silva could attempt to craft a clear message that taps into this middle class discontent. That would pave a third way in Brazilian presidential politics.

More questions than usual

Riordan Roett

THIS ELECTION, UNLIKE THE two previous ones when Lula was "the man," is far more uncertain. Polls indicate that Brazilians are just beginning to focus on the election; television time will be important but we won't see what trends it triggers until late August-early September. Aécio Neves, the front-runner in opposition, needs to focus his campaign on the struggling economy, the rising discontent with poor public services, corruption, and—as always in democratic politics—the desire for change. The discontent over the money spent on the World Cup should play in favor of the opposition, but will that be as relevant in October as it was in July? And can Aécio sell himself with that approach?

It is also too early to see whether Lula will be a game changer. While he is tremendously popular personally, his Workers' Party (PT) is not, and transferring support in any election is a challenge for every former president.

Do we really know what the expectations are of the tens of millions who have moved into the lower middle class?

Across the region democratic politics are being questioned by more and more citizens. The election will be a cliff hanger in October until we know how many first-round ballots will be nullified or turned in blank. Current candidates in Brazil and elsewhere do not seem to generate the kind of enthusiasm seen in past years, especially by Lula in 2002 and 2006. Those were the halcyon days of Brazilian political and economic life—high commodity prices, rising incomes, impressive social mobility; Brazil was a BRIC. Today the polls convey the impression that the country is stagnating. Only unemployment remains low. Do we really know what the expectations are of the tens of millions who have moved into the lower middle class? Are they content with their lives? Will they vote, or will they decide that the election is not particularly relevant to them? Will the mostly urban middle-class voters who protested in the streets last year decide to stay home? Do they see Eduardo Campos or Aécio Neves as able, and willing, to confront the tough choices the next president will need to make—with a divided Congress spread across multiple political parties? The Brazilian legislature is not

Riordan Roett is Sarita and Don Johnston Professor and Director Western Hemisphere Studies at Johns Hopkins University.

noted for its ability to make tough decisions and follow the lead of the Planalto.

If there is a second round of voting, that would appear to be more challenging for Rousseff. The mere fact that a second round will be needed if she does not win outright in October will indicate that the opposition did indeed make inroads during the campaign. Can enough opposition votes, i.e., those for Campos, move into the Aécio column to make the difference? Or will Campos decide to sit it out and wait for 2018, when Rousseff cannot run and the impact of Lula will have had more time to dissipate?

As always, regional politics will play a decisive role. Minas Gerais will vote for Aécio; São Paulo is moving in that direction and a Paulista vice presidential candidate should help the PSDB; Rio de Janeiro and Bahia are less clear; Pernambuco will support its favorite son, Campos.

Elections obviously have consequences. The financial community is delighted that, if Neves wins it appears that Arminio Fraga will return in a leadership role. But will that be enough to persuade the average voter? The country has somehow survived four years with Mantega; does the average citizen understand that a new team must attempt to reestablish confidence in the new government in Brasilia—and that will require hard choices?

> The discontent over the money spent on the World Cup should play in favor of the opposition, but will that be as relevant in October as it was in July?

But the most important aspect of the 2014 election is that the results will be respected. The process itself, not necessarily the candidates, will confirm that Brazil's democratic system is alive and well.



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CAN BRAZIL FIND A ROUTE TO COMPETITIVENESS?

If it is to join up with global production chains, Brazil must confront old problems that inhibit the competitiveness of industry.

Solange Monteiro

THE ASSOCIATION OF São Paulo machining company Globo with aerospace company Embraer is a good example of integration in global production chains. Thanks to its experience as a supplier to Embraer, now one of the top aircraft manufacturers in the world, and investments in technology and training, three years ago Globo began to export to two other manufacturing companies, one Belgian and one American. It now provides 300 types of parts that it manufactures using 100% imported materials; their sales account for 7% of total company revenues. The Globo story illustrates an increasingly clear trend in international trade: the growing demand for imported components for manufacturing products that will themselves be exported. According to the European Union's World Input-Output Database, exports of such goods accounted for 67% of global trade in 2011.

This geographical dispersion of suppliers has grown in recent decades, facilitated by developments in, e.g., telecommunications, management systems, transport, and trade liberalization that have encouraged a deepening of production integration, mainly in North America, Europe, and Southeast Asia. This trend has even helped some countries start to industrialize for the first time, says Otaviano Canuto, World Bank economist, adding, "In the past this was only possible by building up massive-scale industrial

Organizations and specialists are now using a new form of trade flow analysis based not on the gross value of exports but on the country added-value in a final product.

parks. Yet we have now witnessed the increasing inclusion of sub-Saharan Africa as well as countries like Vietnam and Cambodia."

To assess the implications of this trend, organizations and specialists are using a new form of trade flow analysis based not on the gross value of exports but on the country added-value in a final product. Thus, for example, in China services have been realizing a rising share of added-value in areas like design, insurance, management systems, logistics, and financial intermediation. "In 2011 value-added services accounted for about 42% of world trade and gross exports only 20%," said Leane Naidin, specialist in foreign trade at the Institute of International Relations, Catholic University in Rio de Janeiro.

Brazil is still behind the curve in terms of integration into global value chains, with only 11% of foreign inputs in its exports; according to the Trade in Value-Added (TiVA) database, prepared by the Organization for Economic Cooperation and Development (OECD) and the World Trade Organization; in 2009 the country trailed Saudi Arabia and Russia. Considering the size of its economy, Brazil does not import much. Of 133 economies surveyed, it is last in import-to-GDP ratio, according to Lucas Ferraz, economist at the São Paulo School of Economics of Getulio Vargas Foundation (EESP). Angel Gurría, OECD secretary-general, has noted that smaller economies in Latin America demonstrate more awareness of the importance of international integration for improving the competitiveness of their industry. "In Chile, 18% of the value of mineral exports comes from imports, double Brazil's," he says.

More integration of Brazilian industry into global production chains will depend on a change in culture, which will not be easy.

Brazil's problems are the result of issues ranging from poor performance in negotiating trade agreements to such domestic issues as high interest rates, an appreciating currency, a high tax burden, protectionist policies, lack of effective regulation, and infrastructure deficiencies. "The new way of thinking about global production does not imply a new agenda; it merely exposes long-standing Brazilian competitiveness issues," says Sandra Rios, director of the Center for Integration and Development Studies (Cindes). IBRE researcher Mauricio Canedo adds, "It also highlights that a successful strategy for insertion in global value chains cannot emerge from autarchic policies."

Globo has experienced the difficulties faced by Brazilian companies that want to participate in global production chains. To provide products to foreign companies, the company

Brazilian production is poorly integrated with global production chains

Foreign content of exports of selected countries (%)



Sources: OECD and WTO, 2009 data.

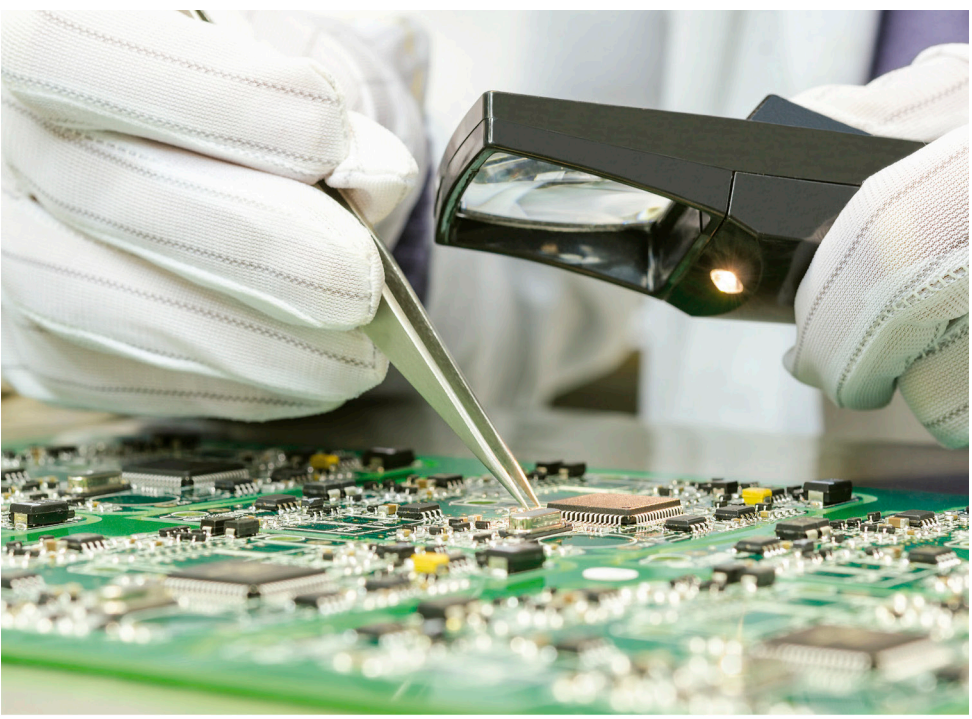
> **"An economy that imposes restrictions on imports deviates from the logic of cost savings and productivity gains that governs the global production chain."**
>
> *Renato Baumann*

invested about R$5 million in management software, machinery, and labor, bringing in export and import specialists in the administrative area, which has now doubled in size. In countries like the United States, the administrative area is leaner because "They do not run into as much paperwork as we do," points out Mauro Ferreira, Globo financial managing director and founder. He believes such factors as red tape and currency instability affect Globo's competitiveness and make it hard to expand. "Europe and the United States are more competitive than Brazil," he says. "Today, we do not plan to expand exports to more than 10% of our total revenues. Our focus is to expand in the domestic oil and gas sector, where we have an opportunity to grow 30% over the next three years." He adds, "Brazil wants us to export, but does not make it easy."

THE ECONOMIC BASE

Brazil lacks encouragement for geographical dispersion of production for several reasons, starting with how production is structured. It is primarily based on intensive primary goods, such as natural resources, and energy, leaving little room for shared organizational forms of production like those seen in such assembly industries as automotive, aeronautics, and clothing. Rios of Cindes says, "That does not mean that natural resource activities cannot benefit from import or export of high-technology intermediaries, or acquiring services, but we start from a different base."

Experts identify the leap in worldwide dispersion of production activities as having mainly been launched by the expansion of electronics industry, but "We remained out of this trade," says Renato Fonseca, executive manager of research and competitiveness, National Confederation of Industry (CNI). "Unlike Korea, our policy failed to boost semiconductor manufacturing because we had a restrictive law." David Kupfer, Federal University of Rio Janeiro (UFRJ) economist and advisor to the National Bank for Economic and Social Development (BNDES), thinks that one problem at the time was the macroeconomic context: "The Brazilian economy was affected by a balance of payments crisis, low investment



Brazil has remained outside the global electronics industry value chain.

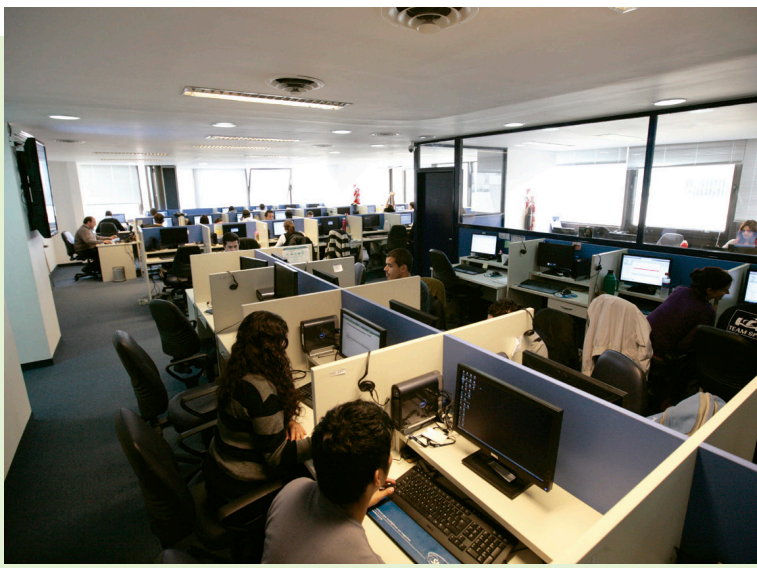
capacity, runaway inflation, and poor financial management; it was not able to take advantage of this wave." As a result, when Brazil began opening up the economy in the 1990s, it had no industrial parks fit for integration into global supply chains.

But even in sectors responsive to geographic dispersion, Brazil's foreign added-value is below the world average. According to José Tavares of Cindes, between 2005 and 2009, in eight branches of TiVA industrial classification Brazil's foreign added-value not only was below average, it actually dropped in four sectors: basic metals and metal products; machinery and equipment; electrical and optical equipment; and transport equipment. Tavares believes that "the high tariffs on imports of intermediate goods and equipment and the precarious transport infrastructure eliminated the efficiencies that companies could obtain by forming lasting partnerships with foreign suppliers."

Smaller economies in Latin America demonstrate more awareness [than Brazil] of the importance of international integration for improving the competitiveness of their industry.

Renato Baumann, director of studies and economic relations and international policy, (BRASSCOM), which has presented a proposal for the ICT sector to candidates for the presidency. In it the organization advocates eliminating bureaucracy, reducing the cost of capital, supporting innovation, increasing exports of software and services, and investing to further integrate the sector into global value chains. Among the goals BRASSCOM champions are the training of 200,000 skilled professionals in five years and expanding the share of ICT in Brazilian GDP (excluding the telecommunications industry) from 4.6% in 2013 to 6% in 2022.

Photo: Release.



Global network

The use of information and communication technology (ICT) to improve the management of companies has made the sector a great ally for many businesses that export. "The need to reduce costs and improve operational efficiency in all segments of the economy has challenged the ICT sector to innovate and take bolder roles in the services sector," says Marco Stefanini, founder and CEO of Stefanini, which provides applications and infrastructure solutions such as enterprise resource planning to customers in more than 30 countries. In 2013 exports accounted for about 15% of company global sales of about US$2 billion. "Exports are increasing by 12% per year, higher than sector growth," the CEO says.

Even though it is seen as a high-cost country, Stefanini says, Brazil has produced good ICT benchmark solutions, helped by having the seventh largest IT budget in the world. "But the critical mass is still too small for Brazil to be a global benchmark," he adds. He believes the ICT industry will become more competitive if it can reduce social security costs and improve staff training.

Stefanini highlights the efforts of the Brazilian Association of Information Technology and Communication

"A successful strategy for insertion in global value chains cannot emerge from autarchic policies."

Mauricio Canedo

Institute for Applied Economic Research, underscores Brazil's high average import tariff on intermediate goods: 10.85% in 2012, compared with 5.64% in Russia, and 5.65% in China in 2011. "An economy that imposes restrictions on imports deviates from the logic of cost savings and productivity gains that governs the global production chain," he says.

UFRJ's Kupfer is convinced that competitive restructuring of Brazilian industry is still not likely: "We are rebuilding in an environment very hostile to industrial activity: a combination of high interest rates and appreciated currency condemns industry to suffer, removing its ability to invest."

POSSIBLE PATHS

Despite the unfavorable outlook, Tavares points out that, according to TiVA data, between 2005 and 2009 Brazilian exports of some industrial goods were quite competitive in four of the eight industrial areas covered by the TiVA index of revealed comparative advantage. Food and beverage, wood and paper, basic metals and metal products, and transport equipment stand out.

In a study commissioned by CNI and published in *Brazilian Industry and Global Value Chains*, experts analyzed potential opportunities in aerospace, medical devices, and consumer electronics production chains. "The first has the advantage of having a Brazilian company at the end of the production chain, leading demand. The medical equipment sector has grown a lot and has the opportunity to participate more in the global production chain," says Fonseca. "As for electronics, Brazil missed the train in semiconductors that sped to Asian countries but has good opportunities in software, since the second wave of production dispersion is research and development of value-added services. As the service sector merges with industry, it opens up opportunities in R&D and software, where Brazil can still get in, and it does not rely on bureaucracy and goods transportation."

HOW TO CHANGE?

Experts are unanimous that there is much to do if such opportunities are to be seized, starting with another look at trade policy and reduction of transport costs. "The movement to trade agreements with broad agendas is not new. It comes from the North American Free Trade Agreement in the early 1990s. We have negotiated several such agreements in the Southern Common Market [Mercosur], but most have not entered into force," Rios says; she also points out that "As yet Mercosur has no investment code, no code for intellectual property, no government procurement agreements, and very little in terms of the convergence of technical regulations, and sanitary standards." She stresses the importance of intellectual property rights in stimulating transfers of technology.

The CNI study highlights the tendency of Brazil's policy makers to promote fully vertical integration of certain industries and to gear industrial policies predominantly to the domestic market. "The 1950s debate on whether Brazil should or should not open the economy to international trade is back," it says.

EESP's Ferraz believes government should now focus on horizontal policies: "They can improve the quality of infrastructure—mainly ports, which are critical to global production chains that work just in time. Trained workers are also vital. A favorable business environment, with enforceability of property rights, ease of starting businesses, and

Photo: Release.



Good winds – The wind turbine industry presents one export platform in Brazil.

transparency, would help to integrate domestic industry into global production chains." Rios of Cindes adds that, "Handing out benefits to different industry segments without addressing competitiveness issues and cost reduction only increases public spending and distorts the productive structure." Another sensitive issue that needs to be better targeted, she says, is the local content requirements: "If you have a new sector or one expanding, such as oil and gas, a targeted policy might make sense. But it must be for a specific good or service, not an entire production chain, because it is not possible to have an entire production chain produced domestically and still be highly competitive."

One sector currently booming is wind power, where investments have exceeded US$5 billion over the last three years and the local content of components of wind turbines is about 70%. Elbia Melo, president of the Brazilian Wind Energy Association, believes that the local content requirements are critical for expansion of the sector. However, some have doubts about the effectiveness of this strategy. Matias Becker, CEO of Renova, a renewable generation company with business in wind and small hydro parks, considers it impossible for government to both generate power at the lowest price and still have high local content. He points out that Renova's last survey found that domestic wind turbines were about 15% more expensive than those produced abroad.

UFRJ's Kupfer believes that more integration of Brazilian industry into global production chains will depend on a change in culture, which will not be easy. "Government institutions and business show no signs that they desire more integration into global production chains. It's instinctive, but it's shortsighted," he says. He concludes that "It's necessary to prepare domestic industry to abandon control of whole sectors and focus on market niches where it has competency to build technology and knowledge to improve productivity and competitiveness."

The 1950s debate on whether Brazil should or should not open the economy to international trade is back.



Much more than just cheap labor

Solange Monteiro

EXPANDING ITS INCLUSION in global value chains is also a task for Mexico, which since it signed the North American Free Trade Agreement (NAFTA) in 1994 has recorded a surge in the activity of maquilas—companies that import components to assemble products for export, taking advantage of low labor costs — and now seeks to increase the value it adds to participation in this global supply chain.

"We seek not only a formal change but more efficient coordination between maquiladoras and the national economy, and greater integration of Mexican industry into the production processes," says Celso Garrido, head of business area finance and innovation, Metropolitan Autonomous University of Azcapotzalco, Mexico City.

Concern over the issue is reflected in the Program of Innovative Development of the government of Enrique Peña Nieto. It expects to increase domestic inputs in the manufacturing sector, the maquilas, and export services from 30% in 2013 to 36% in 2018. For example, the automotive sector has attracted new manufacturers—six in the last four years, among them Audi, Mazda, and Honda—which are taking advantage of Mexico's auto parts industrial base. In the first half of 2014 Mexico's car production surpassed Brazil's.

Another example is the software development hub in Jalisco state, with annual sales of about US$1.5 billion, supported by a federal program to build up the exports of this industry. Among its beneficiaries are IBM, HP, and Oracle. Perhaps the most prominent business to join in recently is the Canadian company Bombardier, which has announced it is opening a new center for advanced engineering in Querétaro. It will be joining an aerospace cluster that since 2006 has been manufacturing parts, such as wings and fuselage of the Learjet 85, in Querétaro.

Garrido explains that these changes are related to two factors: the evolution of the global value chain itself, now with very competitive companies that can relocate operations globally; and more recently with the growing participation of Asian companies, particularly South Korean and Chinese. The US Census Bureau has reported, for example, that in 2001 Mexico and China both imported virtually the same amount of manufactured imports



from the United States, about 12%; by 2010, China had more than doubled its US imports to 27.3%, while Mexico was still at 12.4%.

Garrido also emphasizes the importance of diversification. Costa Rica offers a current example of the risks inherent in dependence on just a few companies. In April, Intel Company announced that it was relocating its Costa Rican manufacturing operations to Asia. Intel, which had operated in Costa Rica since 1997, represented 20% of national exports. "In 1998, total exports of integrated circuits and microcomponents was US$440 million; it had jumped to US$2.37 billion in 2013, an increase of 439%," says Monica Segnini, president of the Chamber of Exporters of Costa Rica. The country is now trying to attract new foreign investors based on the conditions that attracted Intel Company in the first place, such as legal security, skilled labor, and proximity to key markets. Segnini also points out that "Intel also boosted creation of small national companies in technology and machinery that have become providers to other high-tech companies."

According to the Costa Rican Coalition for Development Initiatives, about 250 multinational companies have operations in the country, mostly dedicated to medical technology, film industry, electrical and electronic components, electromechanics, and services. Exports of electrical and electronics and medical and precision equipment totaled US$4.8 billion in 2013, 41.62% of total exports. Segnini thinks that "The medical industry is one of the niches with potential to occupy the space left by Intel."

Global competition

National content of Mexican and Chinese exports by market (%)



Source: US International Trade Comission, April 2011.

In Mexico, more than diversification its productive sectors the big challenge is to lessen dependence on the US market, even though that dominance is to some extent inevitable. In 2009, shortly after the subprime collapse, Mexico's GDP fell by 4.7%—of which 3.3% was related to exports. "Another negative effect we have to consider is that the improved participation in global value chains occurred at the expense of the domestic market and traditional and mature industries with low productivity geared to domestic demand, such as food and textiles," says Garrido. "Today, we have a dual economy: a modern sector globally inserted, but at the same time a domestic economy formed by small and medium enterprises disconnected from this process. This is reflected in the quality of our growth. We have to promote domestic businesses so they, too, reach a high level of competitiveness."

Photo: OCDE/Herve Cortinat.



Brazil: Making progress but still far to go

Angel Gurría

Secretary-General of the Organization for Economic Cooperation and Development (OECD)

Solange Monteiro

Since Angel Gurría of Mexico took over as Secretary-General of the Organization for Economic Cooperation and Development (OECD) in 2006, he has reinforced the OECD's role as a hub for global debate on economic policy issues. He has also launched "New Approaches to Economic Challenges," an OECD process for reflecting on and learning from lessons from the global crisis. In 2011 OECD launched the Better Life Index, which shows how the population of the 34 OECD members plus Brazil and Russia perceive their quality of life. Last June, with support from FGV Projects, the report was published in Portuguese. "It is clear that Brazil has recorded significant progress in the last decade regarding the quality of life of its population," said Gurría. However, he calls for developing countries to speed up structural reforms and argues for investment in policies that boost productivity and competitiveness to lead the country to more balanced growth.

***The Brazilian Economy*—In June the OECD published the Better Life Index. How does Brazil compare with other countries?**

Angel Gurría—The Better Life Index, launched in 2011, consists of regularly updated well-being indicators and an analysis, published in the report *How's Life?* and as an interactive web application. The Index allows citizens to compare well-being across 36 countries, based on 11 topics the OECD has identified as essential in terms of material living conditions and quality of life.

Brazil has made significant progress over the last decade: In general,

Brazilians are more satisfied with their lives than the OECD average, with 80% saying they have more positive experiences in an average day compared to the OECD average of 76%. In Brazil, over 67% of people aged 15–64 have a paid job, slightly more than the OECD average of 65%.

However, the Index also shows that Brazil must deal with significant challenges, particularly social. In Brazil, 43% of adults aged 25–64 have earned the equivalent of a high-school degree; the OECD average is 75%. Among people aged 25–34, 57% have the equivalent of a high school degree compared to the OECD average of 82%. That shows significant progress in educational attainment.

Basically, Brazil ranks above average in subjective well-being, work-life balance, and social connections, but below average in civic engagement, housing, jobs and earnings, environmental quality, health status, personal security, education and skills, and income and wealth.

Brazil ranks above average in subjective well-being, work-life balance, and social connections, but below average in civic engagement, housing, jobs and earnings, environmental quality, health status, personal security, education and skills, and income and wealth.

The Brazilian Institute of Economics (IBRE) charges that the main challenges the country faces are domestic. Does the OECD agree?

We agree that most of Brazil's challenges are domestic, especially since the global economy is recovering slowly. Brazil's exposure to international trade is fairly low; exports are only about 13% of GDP so domestic demand will remain the main pillar of growth in Brazil. But with the right policies, exports could do much more for Brazil's growth.

To take advantage of this opportunity, Brazil would have to improve its competitiveness. Supply-side constraints, such as pressing infrastructure bottlenecks and a high tax burden, exacerbated by an onerous and fragmented tax system, are increasingly impeding growth. A tight labor market and continuing skill shortages have caused surges in wages. And although credit is rising at a substantial pace, investment financing at longer maturities continues to be scarce. Lack of private participation is impeding development of long-term credit markets, owing to an uneven playing field caused by strong financial support to the National Development Bank, which dominates long-term lending. Competitive pressures could also be strengthened by lowering trade barriers, as domestic producers continue to be shielded from foreign competition.

It is also crucial to continue the progress on reducing poverty and income inequality. Conditional cash transfers have proven effective in addressing poverty and inequality and enhancing incentives to invest in human capital. However, social expenditures have been heavily focused on pension payments. Wider access to education has allowed more Brazilians to move into an expanding number

of better-paid jobs. However, the quality of education has not kept pace with the impressive expansion of the system. There are severe shortages in physical infrastructure, a large number of students still drop out of secondary education, and vocational education is limited, although increasing.

Should the next Brazilian government change the economic model to prioritize domestic consumption?

Brazil certainly needs more investment. The recent slowdown has exposed structural weaknesses in the economy's supply side, which were less visible during the commodity boom; among these weaknesses are a fragile manufacturing sector and too little investment and savings relative to GDP. Rebalancing demand from consumption to investment could raise output growth, increase the resilience of the economy, and even have beneficial effects for productivity. So how do we get there?

Supply-side constraints, such as pressing infrastructure bottlenecks and a high tax burden, exacerbated by an onerous and fragmented tax system, are increasingly impeding growth.

To attract investment demand requires addressing such structural economic constraints as infrastructure deficiencies, high labor costs, low skill levels, a high tax burden and an onerous tax system, excessive administrative burdens, shallow credit markets, and barriers to international trade.

How do you evaluate the social policies that have reduced inequality in Brazil? Will it be possible to maintain the same strategy when public finances are less favorable?

Brazil has made remarkable social progress. While income inequality continues to be high by international standards, both inequality and poverty have fallen substantially over the last two decades. Economic growth can explain almost half of this progress, but social policies have helped many households to escape poverty. The two pillars of the successful policy strategy to support social progress have been improved access to education and increased transfer payments.

The conditional cash transfer *Family Grant* program has proven to be a powerful and well-targeted tool to reduce poverty with hardly any leakage. By making transfers conditional on school attendance and basic health check-ups, it also lays the foundations for families to move out of poverty over time. The authorities could now consider raising *Family Grant* benefits, which currently cost less than 1% of GDP.

The federal minimum wage, whose real value has almost doubled over the last decade, has reduced income inequality but has also driven up labor costs, which affects Brazil's competitiveness. As a share of the median wage, it is 69% higher than in any OECD or BRICS country except Turkey. The current rule for automatic increases, which expires in 2015, could be replaced by a rule that indexes annual

minimum wage increases to the consumer price index for low-income households, plus only part of productivity gains for a given period. Such a rule would protect the purchasing power of minimum-wage earners, and reduce without halting, future real increases in the minimum wage.

Pensions have also reduced inequality and poverty, but the automatic rule that individual pensions cannot be lower than the fast-rising minimum wage has made the pension system increasingly expensive. ... Lowering future pension increases while ensuring that pension purchasing power continues to rise would release funding for *Family Grants* and benefit children and youth, whose poverty rates are well above average. ... It has been estimated that the effect on inequality of a marginal increase in *Family Grant* benefits is many times greater than an increase in pensions.

Competitive pressures could also be strengthened by lowering trade barriers, as domestic producers continue to be shielded from foreign competition.

Critics of the Brazilian growth model say that the quality of the growth it has generated is low and low-productivity services represent a significant share of GDP. Would the OECD agree?

Industry's real labor costs have been rising steadily in recent years, outpacing productivity by a sizable margin even as productivity growth slowed. The concurrent loss of external competitiveness can only partly be explained by nominal exchange rate developments. Industry is more exposed to external competition than services and there is also a gradual structural shift from industry to services, where the scope for productivity gains is much more limited than in other sectors. Addressing the policy challenges that hold back industrial productivity and competitiveness would lead to more balanced growth across the board.

How does the OECD evaluate the use of "creative accounting" and other transparency issues, such as the concession of areas of deep sea oil to the state oil company without a public tender?

Trust in public administration is needed more than ever. Enhancing integrity and transparency and preventing corruption should be the priorities of every public administration. The OECD recently published an Integrity Policy Review which recognizes that Brazil has made significant progress with regard to transparency in public expenditure, using new technologies to provide free real-time access to information through the Transparency Portal and other transparency pages.

The OECD also has a number of Principles for Integrity in Public Procurement. The prominence of procurement as a policy instrument relates to its total value: general government procurement accounts for 4% to 14% of GDP in OECD member countries. In Brazil, conservative estimates suggest that general government procurement accounts for about 8.7% of GDP. However, enhancing integrity in public procurement is not simply about increasing

transparency and limiting management discretion but also about recognizing the risks inherent throughout the entire procurement cycle, specifying appropriate management responses to the risks, and monitoring the impact of risk-mitigating actions.

Brazil's fiscal framework calls for a gradual decline in the debt-to-GDP ratio by generating primary surpluses; the current nominal target is 3.1% of GDP. Although this has delivered good results, there have been recent instances where the level of spending could not be reconciled with the nominal primary surplus target without unusual accounting measures: quasi-fiscal operations involving public banks, and exempting certain expenditure items from the primary surplus. While legal, these measures were not used as much in previous years and complicate analysis of the actual fiscal policy stance, suggesting that it might be more expansionary than highlighted by the primary surplus alone. Fiscal clarity should therefore be reinforced by avoiding quasi-fiscal operations, changes in definitions, and special exemptions.

Brazil might also have a legitimate need for more flexibility to conduct countercyclical fiscal policy. This could be obtained by redefining the fiscal rule so as to take cyclical factors into account. One relatively easy way forward could be to replace the current fiscal target by a rule that public spending would only be allowed to expand along a predetermined path, defined by medium-term expenditure ceilings. Since automatic stabilizers operate mainly through the revenue side, an expenditure rule allows them to operate almost fully. This is an attractive choice because it is relatively easy to explain to a broad audience and easy to monitor. Expenditure rules are also useful to support fiscal consolidation and are consistent with the general conclusion that fiscal adjustment is best done on the spending side.

Brazil certainly needs more investment. The recent slowdown has exposed structural weaknesses in the economy's supply side, which were less visible during the commodity boom.

What are key factors for Brazil to promote the competitiveness of its economy?

In Brazil, supply-side constraints are increasingly impeding growth. At the same time, participation in international trade and its integration into global production chains is less than what would be expected in an economy as large and sophisticated as Brazil's, and domestic producers continue to be shielded from foreign competition.

Continuing efforts to consolidate indirect taxes into a single value-added tax are paramount, as the costs of tax compliance in Brazil are exceptionally high. The rise of labor costs could be limited by containing minimum wage increases as previously suggested. Private long-term credit markets could be fostered by gradually phasing out financial support to BNDES, and by focusing BNDES lending on the financing of infrastructure, small and medium enterprises, and innovation. Brazil should also reduce tariff protection, phase out local

content requirements, and target support to specific sectors.

How do you see the insertion of Brazil, and Latin America generally, into global value chains?

The Brazilian economy has fairly little exposure to international trade. Together, imports and exports are only about a quarter of GDP, significantly below that of countries of similar size, even though the comparison does not account for differences in geographic remoteness and other factors.

This low integration is somehow emblematic for Latin America, although an exception is Mexico, which has strong import content in its exports, rising from 26% in 1995 to 30% in 2009. In Chile, which unlike Mexico does not have a large developed country as a neighbor and has a significant share of mineral exports, 18% of the value of its exports comes from imports, twice as high as Brazil's 9%. In a world dominated by global value chains, the low level of foreign content in Brazilian exports might make some industries less competitive.

Despite some progress producers are also more shielded from foreign competition in Brazil than in other countries. Higher tariff protection reduces competitive pressures that would spur firms to reach global best practice; it also hurts downstream sectors that use these products as intermediate inputs or capital goods. Meanwhile, Chile, Colombia, Mexico, and Peru have actively promoted integration with large markets such as Japan, China and the United States through bilateral agreements. Brazil should give preference to horizontal policies to improve the cost competitiveness of local producers, rather than trade protection measures, even temporary ones, that blunt competitiveness.

The federal minimum wage, whose real value has almost doubled over the last decade, has reduced income inequality but has also driven up labor costs, which affects Brazil's competitiveness.

Services account for only 14% of Brazil's gross exports but more than 33% of its exports in value-added terms, indicating that Brazil's exports of goods rely intensively on services inputs. In 2013 Brazil exported services worth US$39.1 billion and imported services valued at US$86.6 billion. … According to the latest AT Kearney Global Services Location Index, Brazil is the 12th most competitive international location for offshore services. However, this industry requires regulation that ensures a favorable business environment. The OECD Service Trade Restrictiveness Index (STRI) shows that Brazil has more restrictions on trade in services than in any other sector except accounting…. The sectors with the highest STRI scores for Brazil are air transport, courier services, and broadcasting.



Will the new BRICS institutions make a difference?

Lia Valls Pereira
IBRE Researcher

THE SIXTH SUMMIT of the BRICS, held on July 15, 2014 in Fortaleza, Ceará state, announced establishment of the BRICS Development Bank and an agreement to pool BRICS currency reserves. The initiative coincides with the 70th anniversary of the Bretton Woods conference that created the International Bank for Reconstruction and Development (World Bank) and the International Monetary Fund (IMF).

The new BRICS institutions do not compete with the Bretton Woods institutions but may—or may not—contribute to the architecture of a new international financial system. Though not new, this topic has gained prominence in the 2008 global crisis and the rise of emerging countries, especially China, on the list of the world's leading economies.

BRICS Bank

Bhattacharya and Romani (2013) estimate that each year from US$800 billion to US$990 billion is spent on infrastructure projects in developing countries (including "emerging" countries). Projects are financed by national governments (57%), the private sector (25%), national development banks (10%), multilateral development banks and official aid programs (6%), and other resources (2%). The authors estimate, however, that between US$1.8 trillion and US$2.3 trillion will be needed annually over the next 10 years to ensure construction of the necessary infrastructure in these countries. Is this a reason to create a new development bank?

The authors believe it is. Current financing is limited by operational and political restrictions. National governments restricted public spending as their deficits rose in response to the 2008 crisis. Infrastructure projects involve long-term investments that crowd out private investment, especially in less-developed countries. Multilateral banks provide only a small share of resources, they require guarantees that limit the investment portfolios of countries, and their instruments are not adequate to encourage private sector participation. In the investment portfolios of the multilateral banks, political considerations often override technical considerations.

The limitations highlighted by the authors cover not only the World Bank but the main regional banks: the Inter-American Development Bank (IDB), established in 1959), African Development Bank (AfDB, 1964), Asian Development Bank (ADB, 1966), and the European Bank for Reconstruction and Development (ERDB, 1991). All multilateral banks accept shareholders outside the region, and in all of them the United States is one of the

top five shareholders (Ottenhoff, 2011). The BRICS Bank would be the first nonregional multilateral institution that does not have a U.S. presence. This is the political significance of the bank. But if the political meaning is clear, what is unclear is whether the bank will create a new efficient governance structure to assist in construction of infrastructure projects in developing countries.

The initial capital of the BRICS Bank is US$50 billion, and it may reach US$100 billion. The funds will be directed to sustainable infrastructure projects. The bank will deal with undeveloped countries generally, but the initial emphasis seems to be on the African continent. The headquarters will be in Shanghai, China, with a regional office opening simultaneously in Johannesburg, South Africa. The choice is not fortuitous: The Chinese have a special interest in improving infrastructure in African countries to meet their demand for agricultural commodities, minerals, and fuels.

The premise is that the BRICS Bank would have more flexible criteria for granting loans. However, two points need to be reconciled. First, it should accept a higher risk than the World Bank, for example by giving greater weight to the benefits infrastructure projects bring to developing countries. In that case, the bank should work with the local government on construction of the project and provide technical assistance so that project benefits are guaranteed. The bank would be less risk-averse and give priority to improving the infrastructure of undeveloped countries.

Second, to be financially sustainable over time the bank needs to capitalize. This requires that it obtain a positive investment grade credit rating, as regional multilateral banks have. With this the bank can be less risk-averse, but loans must be guided by technical proposals that justify a project with a cost-benefit analysis that recognizes externalities. Moreover, the bank should accept new shareholders. There is no reason to exclude developed countries as long as the BRICS are majority shareholders.

Reconciliation of these two points will mean new governance for the new multilateral bank. At the moment, it is still unclear how the bank will operate. One advantage for the bank is that China has proven to be good at executing infrastructure projects. This is an issue on the minds of policymakers. Brazil is an example of a country that is struggling to execute its infrastructure projects. Thus, if the BRICS Bank succeeds, it can provide good lessons for Brazil. The bank's presidency will rotate every five years and China only takes over this position after 20 years. This demonstrates the traditional cautious posture of the Chinese.

The new BRICS institutions do not compete with the Bretton Woods institutions but may—or may not—contribute to the architecture of a new international financial system.

Currency Reserve Pool

After the Asian crisis of the 1990s, the Chang Mai Initiative was created to address problems of foreign exchange liquidity in the region. Currently, Association of Southeast Asian Nations members plus China, Japan, and South Korea participate in the initiative, which has a reserve pool of US$240 billion. A country can withdraw up to 30% of its quota from the pool. To withdraw more, countries must have an IMF-supported program to guarantee the additional Initiative lending. The Initiative has been criticized for tying loans to IMF programs and for its likely ineffectiveness, because its resources are not sufficient to overcome regional currency crises and so are only useful to relieve short-term liquidity difficulties.

The BRICS Currency Reserve Pool Agreement starts with US$100 billion, with China contributing US$40 billion, Brazil, India, and Russia US$18 billion each, and South Africa US$6 billion. This is not an agreement to replace the IMF. Here the proposal has a clear political meaning: Although IMF country members have approved new quotas, these have not yet been put into practice. The new quotas are considered a step toward the BRICS goal of IMF sharing voting power equally between developed and developing countries.

In short, the two initiatives—the BRICS Development Bank and the Currency Reserve Pool—are associated with the debate on world financial governance as demand heightens for greater voting power in the Bretton Woods institutions for emerging countries.

In the investment portfolios of the multilateral banks, political considerations often override technical considerations.

World Trade Organization

The World Bank and the IMF are institutions governed by power—a country member's vote is weighted by its quota, which is set according to economic and political criteria.

At the World Trade Organization (WTO), decisions are consensual. Until the late 1990s, the consensus was built by the Quad (Canada, the EU, Japan, and the US). Since 2003, when Brazil, India, and China led the veto of the EU and US proposal for agriculture negotiations in the Doha Round, the consensus has no longer been confined to the Quad. However, a BRICS consensus has not yet emerged. Unlike its consensus on IMF and World Bank reforms, BRICS member interests in WTO reforms have not converged.

The latest BRICS impasse occurred in late July. The Bali Agreement on Trade Facilitation of December 2013 was celebrated as a sign that the WTO had not become irrelevant. For it to enter into force in July 2015, all WTO members were to sign the agreement by July 2014. India, however, has conditioned its signature on a change in the rules that limit the value of the agricultural subsidy, currently 10% of production, because it makes the 2013 food security program unviable. A "peace clause" was voted that would extend the deadline for signing the Bali agreement to December 2017, but the Indian government argument that the rules were not clear was supported by Cuba, Venezuela, and Bolivia.

In this case, the BRICS interest in strengthening the WTO, as voiced in all declarations of its Summits, suffered a serious setback. Differences between the BRICS countries when negotiating trade agreements reflect the interests of their diverse productive sectors that shape political actions. This type of thing also occurs between the US and EU countries. However, in the postwar period both had an interest in maintaining the multilateral system because of the Cold War.

In addition of sharing more power in international financial institutions and advocacy for more flexible rules to accommodate greater autonomy in a country's domestic policies, consolidation of the BRICS will require proposals that arise from common interests. This consolidation will be tested by the BRICS Bank as political and economic asymmetries between its members create difficulties for conduct of a joint project to build a post-Bretton Woods world order.

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