Brazil
Chartering a New Road Map to Global Trade & Investment

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Brazil's economy is at a crossroads. The country's recurrent pattern of trying to boost growth in the past decade by favoring consumption over investment has run out of steam. Punctual fiscal incentives and government procurement for companies and sectors blessed by the country's "local content" industrial philosophy over horizontal policies are not turning out the positive results they aimed to achieve.

At its core, Brazil's (lack of) economic strategy is the expression of an approach that is mostly insular, privileging through every angle its domestic market over a more incisive interaction with the global economy.

But let there be no mistake. The emergence of the Brazilian economy, though unfortunately falling short of its potential, is real and it is here to stay. It is no "mirage". The period from 2003 to the present has been one of great achievements. But these are not sufficient to characterize it as a "Brazilian miracle", as some would have it.

The social and economic accomplishments of the past decade are undeniable, particularly when it comes to social inclusion and the fight against poverty. But Brazil's rise is most impressive when compared with its own recent past or with its Latin American cousins. It is much less so when the comparison is with other global growth players, such as the Asian countries. Still, Brazil is the world's second-largest emerging market, behind only China.

Brazil's current local content policies, if not followed by the necessary parallel investments in training, education and R&D, will have less to do with enhancing an endogenous capacity to compete and more to do with protectionism plain and simple. While there has certainly been improvement in the lives of the poorest, the low productivity of the Brazilian worker is setting lower ceilings for future income gains.

Brazil has to avoid a scenario in which competitiveness is lost and the country deindustrializes faster than it reindustrializes (in sectors where local content rules have fostered investment). If that proves to be the case, a high level of employment can only be maintained with new paternalist protection for local industries — even more so as prices and production costs are high compared to international standards.

The country's fiscal burden, at around 37% of GDP, and parochial labor regulations, continue to play against Brazilian competitiveness and hold back the country's potential. And there is obviously a limit to the flow of foreign direct investment (FDI) into Brazil geared towards setting up local operations, so that companies can gain the credentials needed to sell to the Brazilian government or to companies in which the government is a shareholder.

Brazil counts on the voracious appetite of its domestic market as a countercyclical advantage. Recently, industrial policies based on "local-contentism", the hosting of mega-events such as the FIFA World Cup and the Olympics and its status as a potential energy superpower have added to the "Brazilmania" hype. They are certainly not the magic ingredients of a miracle. But they allow for more than simply a mirage of economic growth. In this overall picture, a new approach to global trade is absolutely essential.

New Strategy Towards Trade &Investment

One thought the global crises of both 2008 and 2011 might cause Brazil's development strategies to embark on new paths. Its currency, the real, could be further depreciated — thus increasing Brazil's emphasis on exports. That is actually happening. In May 2011 the US dollar traded at R$ 1.6 — now (March 2014) it has climbed up to R$ 2.3. Brazil can no longer blame the "currency wars" for its economic ills. An important part of Brazil's capacity to compete therefore shifts to the ability of its organizational structure, particularly at government level, to deal with foreign trade and attract productive investment.

Becoming more of a big player in the global economy would definitely represent a major change for Brazil, which has traditionally looked to its domestic market as *the* driver of growth. Such an inward-looking approach was praised as largely responsible for the way Brazil brushed off the "Great Recession" that broke out in September 2008. The economy's impressive 7.5% growth in 2010 led some analysts to conclude that internationalization of Brazil's economy would be a mistake.

But that is not true. China and South Korea also faced the crisis with comparative success — and both boast more than 50% of their GDP related to international trade. Brazil's disappointing growth of 2.7% in 2011, 1% in 2012 and 2.3% in 2013 caused disenchantment with the idea of an ever-expanding, inward-oriented growth trajectory for Brazil, immune from events in global markets.

Many in Brazil believe the country's slim participation in world trade (less than 1% of everything bought and sold worldwide) and of international trade in Brazil's economy (exports + imports make up only about 17% of GDP) is the result of protectionism in rich countries; and that this "injustice" may only be corrected through negotiations of the "government-to-government" type, like those carried out between the European Union and Mercosur, or at the World Trade Organization (WTO). Hence the emphasis the Brazilian government placed on the campaign that ended up electing Roberto Azevedo as director-general of the WTO.

Undoubtedly, "government-to-government" negotiations are very important. Industries in which Brazil presents clear competitive advantages, such as biofuels, agriculture and many others, are being held back by unfair trade rules. But in many trade talks Brazil now seems to be losing the moral high ground. Its local content rules and seasonal import tax hikes are increasingly seen by its partners as disguised — and often flagrant — forms of protectionism.

However, there are decisions — that are Brazil's alone to take — which are more relevant than the outcome of those slow-paced negotiations. For example: Does Brazil see trade as one of its main roads towards a larger role in the global economy? Does Brazil want foreign trade surpluses to become a means of building up domestic savings and, therefore, the resources needed for investment?

If the answers to these questions are affirmative, asymmetries in international trade should not represent a "paralyzing excuse" for inaction in Brazil's trade promotion efforts. Multilateral "government-to-government" agreements were not the main reason why some emerging economies expanded exponentially over the past 30 years.

South Korea, China and Chile have increased their national incomes dramatically without placing multilateral agreements at the center of their economic and business strategies. Concentrating on the pursuit of a "happy ending" for multilateral negotiations makes Brazilians lose focus. Brazil must replace simplistic notions such as "overseas markets might be of interest to Brazil if protectionist barriers were lifted" by questions like "what is our trade promotion strategy in a world where trade rules remain unfair?"

In a currency environment that could facilitate Brazilian exports of higher value-added goods, it is high time to redefine how Brazil approaches foreign trade. Formulating, negotiating and promoting trade policies, as well as resolving disputes, is extremely complex. Brazil needs more people, more coordination and more focus if it wants to increase its share of global trade.

In this context, it is key to promote coordination at the top and enlargement at the bottom. Today responsibility for trade and investment strategies is scattered throughout a myriad of ministries.

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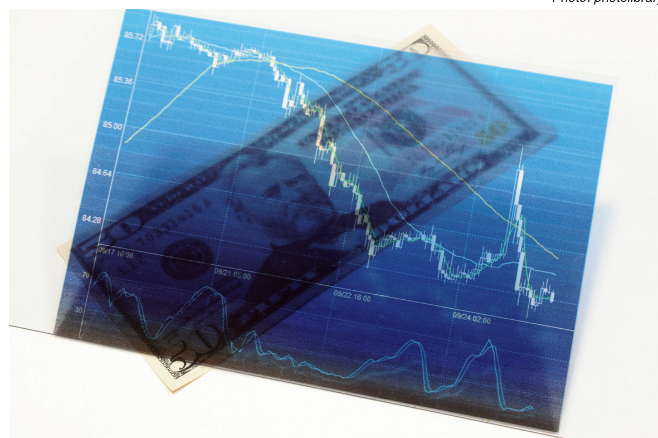

More of Brazil's states and cities should undertake trade and investment promotion. If it were a country, the state of São Paulo would be South America's second-largest economy. But it doesn't have the network of people and offices it needs to promote itself abroad.

And Brazil should make better use of its embassies and consulates around the world. They should become true "showcases" of the best Brazil has to offer. They could also be "antennae" of scientific and technological opportunities, especially as Brazil implements programs such as "Science without Frontiers" and the theme of innovation seems to have definitely registered on Brazil's radar screen. Recent decades show us that countries that sought internationalization have been more successful than those tied to their domestic markets. Brazil must learn that lesson.

Alongside multilateral negotiations, Brazil must enact urgent labor, social security and tax reforms. In addition, however, there is a quartet of priorities: facilitating domestic legislation for export-oriented firms; improving the country's logistics infrastructure; training specialized human resources in the public and private sectors for trade promotion and attracting foreign direct investment; and strengthening the international presence of small and mid-sized enterprises through the establishment of export consortia.

These initiatives focused on a project for prosperity are much more important for Brazilian society than the uncertain entry of Brazil into the exclusive clubs of the multilateral system, such as the UN Security Council. It is therefore essential that the new competitive level of the Brazilian currency is accompanied by an updated and more robust structure for Brazil's business objectives. These are much-needed — and yet basic — steps towards a new global competitiveness for Brazil.

Changing Brazil's Economic DNA Towards Value-Addition

The future for Brazil lies in making its companies tech-intensive in various industries. There is nothing more strategic for Brazil than the

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challenge of transforming its creative people into a society of entrepreneurship and innovation. And that is why Brazil has to keep changing its economic DNA. The timid expansion of Brazil's GDP since 2011 deals a hard blow to the notion that its policy makers had devised an economic model uniting high growth with social inclusion. It is wrong to assume that the set of policies Brazil has put in place in the past few years to boost its economy and upgrade its social data are pillars of a new development model.

What does exist in Brazil, stretching back beyond current President Dilma Roussef (2011-present) and her predecessor Luiz Inácio Lula da Silva (2003-2010), is a cyclical attempt to promote growth that constitutes a "pattern". It is based on the appetite of Brazil's domestic market for high levels of consumption. The pattern has indeed been accompanied in the past 10 years by income distribution mechanisms that lifted the lives of millions. They are, however, targeted at poverty alleviation — not increasing productivity — and therefore are not engines for sustained development over time. This pattern made Brazil fall in love with the present.

Brazil has to choose a development model and adopt it wholeheartedly. Interest payments, pensions, public sector wages, government inefficiencies and intricate business regulations keep Brazil from pursuing a development road paved by science, technology, innovation, start-up capital and entrepreneurial spirit. The country has a hard time putting together a priority list and sacrificing for it. But Brazil presents clear potential for the old economy of commodities to build new competencies in tech-intensive sectors.

Again, this would necessarily involve the many areas in which Brazil has comparative advantages, such as agribusiness, mining, deep-water oil and biofuels. These should be the bases for a new economic platform to generate surpluses and service the construction of new competitive advantages in nanotechnology, bioengineering, biotechnology, high-value chemicals, new materials and robotics. These are the vehicles that could drive Brazil to an even higher plateau when it comes to emerging markets.

The current reinterpretation of import substitution policies in Brazil is a good example of the difference between a development model and a growth pattern. Nearly all experiences in industrial development around the world have resorted to some sort of import substitution. This is almost a necessary stopover to local capacity building. Import substitution, however, cannot be seen as an ever-lasting golden rule. It is only to be applied at an infant-industry level so as to enable a particular sector of the economy to compete internationally.

Brazil must raise domestic savings and investment as a percentage of GDP and direct more resources to education, science and technology — the indispensable tools to fight crises and promote sustained prosperity. Embarking on a serious effort to enact much-needed structural reforms will free Brazil from the current microeconomic straitjackets. They would be the best stimulus the Brazilian government could offer all those willing to help the country develop its potential to the fullest.

Brazil's (Lack of) Economic Road Map from an International Relations Perspective

From an international relations perspective, such an insular approach to its economy reveals a great deal about Brazil's lack of a sophisticated project in terms of both influence and prosperity. Present-day Brazil, with significant economic expansion at bay now for more than two years, is the corollary of a political economy of ideological preferences, with a stronger accent on "political affinities" and lesser attention to "economic pragmatism".

Globally, the past decade has heard Brazil's political discourse sound much louder than its cross-border economic achievements. Its idea of global reputation is intertwined primarily with bringing the United Nations system up-to-date — becoming a permanent member of the Security Council, strengthening ties among Latin American countries, praising the benefits of South-South cooperation. In short, a foreign policy permeated by "good intentions" and "balanced" relations with the world's top players.

But the fact is recent attempts undertaken by Brazil to build strategic political partnerships that could have a positive influence on economic spheres, such as with China or France, have been unilateral in most cases. Brazil's bilateral trade with China has increased 10-fold in the past decade. But that has been mostly the outcome of China's dramatic infrastructure and consumer market growth — and the ensuing voracious appetite for mineral and agricultural commodities in which Brazil presents clear comparative advantages. One ton of Brazil's exports to China hover around $200. One ton of Chinese exports to Brazil exceed $2,000. That could hardly be called a "partnership".

Brazil's interests in Africa are overshadowed by the expanding outreach of Chinese corporations. UN reform is nowhere near the horizon. And the different geometries fostered by Brazil in Latin America, either using Mercosur, the Union of South American

Nations (UNASUR) or the Community of Latin American and Caribbean States, yield more of speeches on how the world should be made more equitable — and much less tangible economic results.

Clearly enough, Brazil's global agenda has privileged its political objectives — modulated by the ideological preferences of the day — over a set of economic initiatives that might have included more bilateral free trade agreements (FTAs). Since Mercosur was created in the early 1990s, Brazil has only concluded three FTAs (with Egypt, Israel and Palestine), whereas Mexico since NAFTA counts in excess of 40 FTAs in place. Brazil's ideological biases of the past 10 years, coupled with the finest breed of protectionism-prone American conservatives, have helped put the idea of a Free Trade Area of the Americas to rest.

The lower rank status awarded by Brazil to structuring its foreign economic goals has prevented a more aggressive stance in trade and investment promotion. Brazil should have strengthened and expanded its brave APEX (Brazil's trade and investment promotion agency) founded during the Fernando Henrique Cardoso administration in the 1990s which now houses a few dozen officials based mostly in Brasília. Instead of setting up muscular business bureaus in the global cities of North America, Europe or Asia, Brazilian strategists believed they were taking steps toward greater global stature by opening diplomatic posts in cities like Baku, Belmopan, Basse-Terre, Castries, Conacri, Cotonou, Khartoum, Gaborone, Malabo, Nouakchott, Roseau, St. Georges, St. John's and Ouagadougou.

Seemingly clueless of — or oblivious to — the major trends driving the global economy, Brazil was taken by surprise with the announcement that the US and Europe are working towards an FTA to come into force in 2015. As news on the future transatlantic deal came out, a high-ranking official of Brazil's presidency told newspapers Brazil had been following ongoing negotiations "without the hastiness of a subordinate".

But Brazil should better decide whether it wishes international trade to be one of the prime sources for its desired economic development. Brazil's economic relations with its Latin American cousins, given the comparatively small scale of these economies as buying markets, represent a low ceiling for its needs. Furthermore, the presently more dynamic economies of Latin America (Colombia, Peru, Chile and Mexico) are reconfiguring their strategies and joining forces in an FTA of their own, one that will entertain an open trade dialogue with the United States.

As per further access to Europe's markets, Brazil's negotiating maneuverability is rendered less flexible as it lives up to the limits imposed by its membership of Mercosur. The diametrically opposed views on the part of both Mercosur and EU countries — especially when it comes to the agricultural agenda — also keep negotiations from expanding to other areas. Were Brazil to make its local content requirements more flexible, particularly in areas related to infrastructure, transport and logistics, a new phase in Brazil's economic relations with Europe could be launched. But that would be going against Brazil's current industrial policy mantra.

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When it comes to the BRICs, Brazil certainly revels in China's demand for its low value-added exports. But Brazil's industry has no stamina to face China's hypercompetitiveness — so there is no FTA in sight here. Russia and India also carry great potential as Brazil's trading partners, but they lack both the geographical circumstances and natural complementarities that are conducive to forming economic blocs. The BRIC nations will coordinate common positions in economic and political fora, and will definitely trade more among themselves. They may even come up with preferential credit lines, or a BRIC Bank, to help finance infrastructure projects. But given the scale of the items in which their interests do not converge, they will never constitute an FTA, much less a vertical, deeply-integrated economic zone.

As a consequence, Brazil, especially in comparative terms, will keep a low profile in global economic statistics. The country's share of world GDP today is at only 2.9%, the same it had in 2002. With the watershed event of the US-EU transatlantic FTA now in the making, Brazil should get its act together and add a sense of urgency to defining its place in the map of 21st century trade and investment.

Without a privileged interaction with the most important markets of the world, Brazil would be rendered a less relevant, "bloc-less" economic player. Alternatively, if Brazil makes the right choices now, it can no doubt use the productivity and competitiveness of its agro-energy sector to help foster a tech-intensive, globally connected economy. **JS**

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