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...”

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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.

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 (%)
“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...
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.”

Renato Baumann, director of studies and economic relations and international policy,

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 (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.

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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...
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.”

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