A Greater Brazil?

INDUSTRIAL POLICY, COMPETITIVENESS, AND GROWTH

Brazil-U.S. Business Council

The Greater Brazil Plan

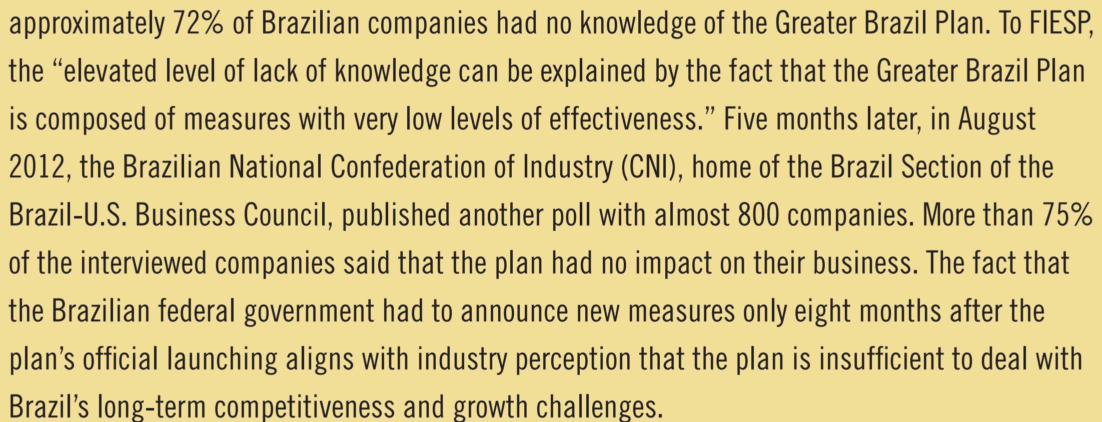
On August 2, 2011, Brazilian President Dilma Rousseff announced the so-called Greater Brazil Plan (*Plano Brasil Maior*), an industrial policy aimed at improving local industry competitiveness to sustain growth and job creation in a time of economic uncertainty. The Greater Brazil Plan is the third industrial policy announced by the Brazilian federal government in the past decade, following the 2004 Industrial, Technological, and Foreign Trade Policy (PITCE) and the 2008 Productive Development Policy (PDP). It also falls into a long-established tradition in Brazil of centrally planned, multiyear industrial policies to accelerate economic development, first initiated in 1947 with the Health, Feeding, Transportation, and Energy Plan (*Plano SALTE*).

President Rousseff announced the Greater Brazil Plan as an all-encompassing industrial policy anchored in systemic and sectoral strategies, including different economic goals. Its design and implementation, however, point to a patchwork of previously announced as well as new measures mostly related to trade policy, in particular to import administration. The original version of the plan does not seem to address structural challenges faced by the Brazilian industry, such as high interest rates, high energy prices, lack of adequate infrastructure, a burdensome tax system, and poor regulatory practice. It falls into another Brazilian tradition of using and labeling tax and trade-related measures as "industrial policy" to offer the local industry short-term relief from foreign competition through subsidies and protection.

One year after its announcement, Brazilian business groups often consider the plan important but insufficient to cope with slow economic growth and job creation, potential deindustrialization, and, most important, Chinese competition in Brazil and in third markets—the Greater Brazil Plan's main undeclared target.

Plan Effectiveness

In March 2012, the Brazilian Federation of Industries of the State of São Paulo (FIESP), the representative of Brazil's manufacturing powerhouse, published the results of an opinion poll of more than 300 manufacturing companies in all sectors. According to the federation,



approximately 72% of Brazilian companies had no knowledge of the Greater Brazil Plan. To FIESP, the "elevated level of lack of knowledge can be explained by the fact that the Greater Brazil Plan is composed of measures with very low levels of effectiveness." Five months later, in August 2012, the Brazilian National Confederation of Industry (CNI), home of the Brazil Section of the Brazil-U.S. Business Council, published another poll with almost 800 companies. More than 75% of the interviewed companies said that the plan had no impact on their business. The fact that the Brazilian federal government had to announce new measures only eight months after the plan's official launching aligns with industry perception that the plan is insufficient to deal with Brazil's long-term competitiveness and growth challenges.

Logic Behind the Plan

The Rousseff administration took office in January 2011 amidst a continuing international crisis and growing domestic inflation due to the fallout of the countercyclical policies adopted by the Lula administration in the context of the 2008–2009 economic crisis. In addition, the overvalued Brazilian currency—the Real—was putting pressure on Brazil's domestic industry, particularly due to growing Chinese competition in Brazil and in third markets. As a result, the incoming administration concluded that it needed an emergency policy to rescue the Brazilian manufacturing sector.

Available Options

When the Greater Brazil Plan was conceived in 2011, it seemed that the Rousseff administration had at least three major options to address the competitiveness and growth challenges faced by domestic industry.

First, the administration could have pursued policies to address structural problems by seeking tax, labor laws, and Social Security reforms as well as reducing interest rates, streamlining regulations, and increasing infrastructure investment. These initiatives, though, would have taken awhile to show results. Moreover, reforms would require congressional action by a large but loose multiparty coalition dogged by corruption scandals and by President Rousseff's personal commitment to oust allies involved in them.

Second, the administration could have pursued an exchange rate policy to force a devaluation of the Brazilian currency, effectively subsidizing domestic industry while raising the overall level of protection of the economy. However, with increasing inflationary pressures caused by the fallout of the previous economic stimulus policies, such a move could have put Brazil's macroeconomic framework at risk. As a result, the administration decided to keep the exchange rate policy in place while pursuing two parallel policies. The first was a gradual increase in capital controls primarily through the use of a Tax on Financial Operations (IOF) in order to discourage hot money flows to the Brazilian market. The second was to frame the financial debate in multilateral fora by including currency manipulation in the G-20 agenda and the relationship between trade and currency manipulation in the World Trade Organization (WTO) program of work.

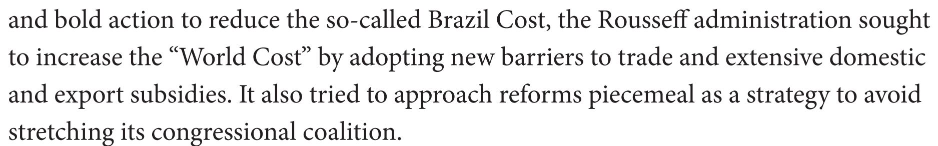
Finally, the administration could have adopted a collection of previously announced as well as new measures, mostly in the area of trade policy, to temporarily reduce the pace of growth of Brazilian imports and to provide short-term breathing room for the domestic industry.

Power to Tax

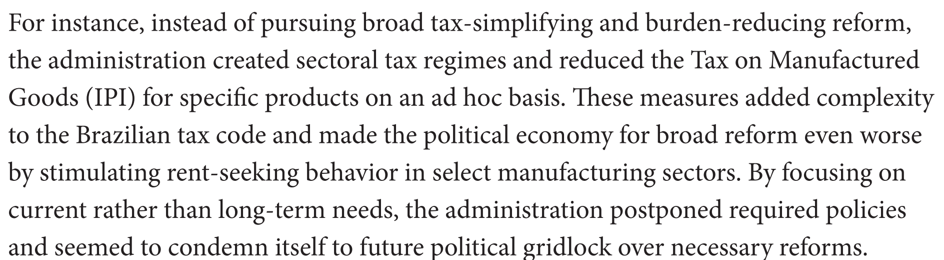
The U.S. Constitution assigns to Congress the power to "lay and collect taxes, duties, imposts and excise." In Brazil, however, the Federal Constitution of 1988 and domestic legislation allow the executive branch to change taxes without congressional action. The Brazilian executive branch makes extensive use of this power in making fiscal policy through the increase or reduction of the Tax on Financial Operations (IOF), industrial policy through the Tax on Manufactured Goods (IPI), and trade policy through import and export tariffs.

Brazil Cost Versus World Cost

The piecemeal approach of trade and other policy-related measures prevailed and eventually materialized in the Greater Brazil Plan. Instead of pursuing immediate



and bold action to reduce the so-called Brazil Cost, the Rousseff administration sought to increase the "World Cost" by adopting new barriers to trade and extensive domestic and export subsidies. It also tried to approach reforms piecemeal as a strategy to avoid stretching its congressional coalition.



For instance, instead of pursuing broad tax-simplifying and burden-reducing reform, the administration created sectoral tax regimes and reduced the Tax on Manufactured Goods (IPI) for specific products on an ad hoc basis. These measures added complexity to the Brazilian tax code and made the political economy for broad reform even worse by stimulating rent-seeking behavior in select manufacturing sectors. By focusing on current rather than long-term needs, the administration postponed required policies and seemed to condemn itself to future political gridlock over necessary reforms.

Brazil Cost

The so-called Brazil Cost is a concept developed in 1995 by the Brazilian National Confederation of Industry (CNI), home of the Brazil Section of the Brazil-U.S. Business Council, as a way to align different Brazilian manufacturing groups' priorities in terms of domestic reforms to foster competitiveness. There seems to be no formal conceptual definition of the elements that constitute the Brazil Cost, but it generally includes the following components: (1) high interest rates (cost of investment and working capital), (2) high energy prices, (3) lack of adequate infrastructure, (4) high cost of inputs, (5) red tape and compliance costs, (6) burdensome social and labor-related taxation, (7) tax complexity, and (8) lack of tax credit compensation. These are all horizontal issues that have a systemic impact on Brazilian and Brazil-based foreign companies' competitiveness.

Forced Localization

One concerning byproduct of the Greater Brazil Plan is the spread of forced localization measures adopted by the Brazilian federal government. The Rousseff administration has made local content requirements a centerpiece of its industrial policy. While key senior-level officials in the administration share a GATT-think perspective on trade, the

main reason for the spread of these measures seems to be a growing fear of Brazilian deindustrialization caused primarily by Chinese competition in the Brazilian and in third markets. Several U.S. companies, however, are negatively affected by the unintended consequences of these policies.

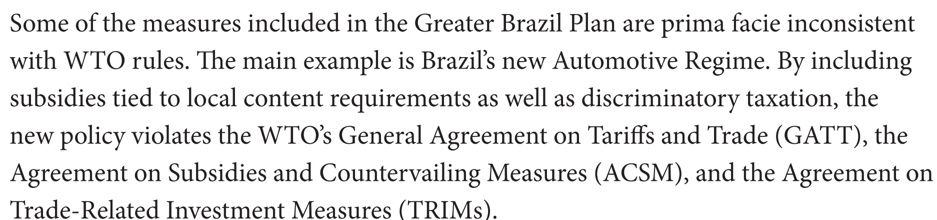
In addition, the administration tends to share a pro-producers industrial policy view, focusing its efforts to address foreign competition in similar products while mostly ignoring the role of a pro-consumers industrial policy that would shift efforts toward the needs of the Brazilian supply chains. One example of this view is Brazil's consistent refusal to join the WTO Information Technology Agreement (ITA) on the grounds that it increases domestic industry exposure to foreign producers' competition and Brazil's trade deficit in the sector. The country, however, ignores the positive impacts of cheaper and better high-tech inputs to its many competitive sectors such as aerospace, agribusiness, energy, and services. As a consequence, concerns of world-class Brazilian companies operating in complex supply chains and ITA-intensive industries such as Embraer, Petrobras, Braskem, and Stefanini are not addressed as those of "industrial consumers." Sectors with substantial foreign presence in Brazil, including automotive and telecom, are also treated this way.

Sectors affected by forced localization measures currently include energy (oil and gas, in particular), equipment and machinery, footwear, health, ICT, media, reinsurance, telecom, and textiles and apparel.

GATT-think

GATT-think is an expression coined by the economist and Nobel laureate Paul Krugman in a 1991 paper. To explain government's behavior in multilateral trade negotiations regulated by the General Agreement on Tariffs and Trade (GATT), he concluded that the negotiating countries followed three simple rules: "(1) Exports are good. (2) Imports are bad. (3) Other things equal, an equal increase in imports and exports is good. In other words, GATT-think is enlightened mercantilism." Still, according to Krugman, GATT-think is "a simple set of principles that is entirely consistent, explains most of what goes on in the negotiations, but makes no sense in terms of economics."

WTO Compliance



Some of the measures included in the Greater Brazil Plan are prima facie inconsistent with WTO rules. The main example is Brazil's new Automotive Regime. By including subsidies tied to local content requirements as well as discriminatory taxation, the new policy violates the WTO's General Agreement on Tariffs and Trade (GATT), the Agreement on Subsidies and Countervailing Measures (ACSM), and the Agreement on Trade-Related Investment Measures (TRIMs).

In addition, there is a potential spread of forced localization measures from government procurement policies to commercial operations. An example is the inclusion of local content requirements in the spectrum allocation bidding conducted by the Brazilian National Telecommunications Agency (ANATEL). The imposition of such requirements in private sector commercial contracts is equally WTO inconsistent.

Positive Developments

The Greater Brazil Plan includes positive measures that are good public policy and constitute an effort to address systemic challenges affecting Brazilian and Brazil-based foreign companies. Key examples are Brazilian federal government initiatives to reduce the tax burden on companies' payrolls, allow for the devolution of export-related tax credits, bridge the financing gap in sectors lacking adequate access to capital, and enforce intellectual property rights at the border.

In addition to these measures, the Rousseff administration has recently been taking bolder steps to address some of the crucial elements of the Brazil Cost. These steps include the reduction of interest rates and the launching of a national initiative involving all of Brazil's 27 governors to simplify the tax system and reduce the tax burden. In addition, the Brazilian government announced in August 2012 thousands of miles of federal highways concessions to the private sector as well as a railroads construction and modernization program based on public-private partnerships (PPPs). The administration's efforts to make concessions to the private sector and engage in PPPs, particularly in infrastructure-related areas, is a positive development.

A More Effective Plan

To make the Greater Brazil Plan more effective in fostering competitiveness and growth in Brazil, the federal government could focus its efforts on addressing the long-term systemic challenges, rather than focusing on short-term goals that make lasting reforms more difficult to achieve. It could also address U.S.-Brazil issues that have the greatest potential to promote efficiencies in the Brazilian economy. In this context, the Rousseff administration could pursue the following goals:

- Continue its policy to consistently reduce interest rates and the cost of investment and working capital.
- Continue its efforts to accelerate public and private investment in infrastructure both through the 2nd Growth Acceleration Program (PAC II) and through growing reliance on PPPs, including infrastructure-related concessions with a particular emphasis on airports, railroads, roads, and ports.
- Reduce the price of energy to industrial consumers, including lowering federal taxes, accelerating pre-salt development with greater international participation, and exploring further opportunities to develop Brazil's natural gas and nuclear power markets.
- Negotiate with the Brazilian National Congress and Brazil's 27 governors to secure a tax-simplifying and burden-reducing tax reform.
- Reform the Brazilian import tariff structure to reflect a supply chain approach, including eliminating tariffs on inputs, rather than an anti-foreign competition and revenue-seeking structure.
- Empower the Brazilian Federal Revenue Authority (*Receita Federal do Brasil*) to administratively settle tax disputes by securing congressional approval of an all-encompassing tax mediation law.
- Streamline regulation by securing congressional approval of a comprehensive administrative procedure law that empowers the Office of the Presidential Chief of Staff (*Casa Civil da Presidência da República*) to impose and enforce regulatory harmonization and transparency throughout the Brazilian federal government.

- Roll back forced localization measures, especially those affecting commercial private sector contracts.
- Roll back WTO-inconsistent Greater Brazil Plan measures.
- Gradually roll back capital controls by reducing and/or eliminating the IOF on certain types of financial transactions.
- Reinforce Brazil's pro-innovation intellectual property system by avoiding the erosion of rights already protected by Brazilian domestic legislation and by modernizing the Brazilian National Institute of Industrial Property (INPI), including fully implementing congressionally authorized hiring of personnel and seeking additional congressional authorization to meet INPI's personnel needs for the next five years.
- Approve Brazil's accession to key international agreements to foster economic efficiency, growth, and job creation, including the WTO Information Technology Agreement (ITA), the World Customs Organization (WCO) Revised Kyoto Convention (RKC), and the World Intellectual Property Organization (WIPO) Madrid System for the International Registration of Marks.
- Continue the fight against corruption and the promotion of an open government, including securing approval of the U.S.-Brazil Tax Information Exchange Agreement (TIEA) by the Brazilian Federal Senate and approving Brazil's accession to the WTO Government Procurement Agreement (GPA).
- Negotiate with the United States pro-business bilateral agreements, including a U.S.-Brazil Patent Prosecution Highway Agreement (PPH) and a U.S.-Brazil Bilateral Tax Treaty (BTT).
- Begin exploratory talks with the United States toward a Bilateral Economic Partnership Agreement (BEPA), including commitments on market access, trade rules, new trade-related issues, and trilateral cooperation-related issues.
- Foster tourism and business promotion through the reciprocal elimination of visa requirements with the United States.
- Create a world-class express delivery system to maximize commercial opportunities related to the sports mega events taking place in Brazil, particularly for small businesses.

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Appendix

Summary of Greater Brazil Measures*	
Establishment of the Brazilian Funds' Management Agency (ABGF)	Fiscal Policy
Establishment of climate-related financing (Fundo Clima)	Fiscal Policy
Establishment of training-related financing (BNDES Qualificação)	Fiscal Policy
Expansion of innovation-related financing (BNDES and FINEP)	Fiscal Policy
Expansion of sector-specific financing (BNDES "Pro" programs)	Fiscal Policy
Expansion of trade-adjustment financing (BNDES Revitaliza)	Fiscal Policy
Expansion of working capital financing (BNDES PROGEREN)	Fiscal Policy
Extension of countercyclical financing (BNDES PSI)	Fiscal Policy
Harmonization of state-owned banks policies	Fiscal Policy
Allowance of technological risk contracts in government procurement	Innovation Policy
Financing of not-for-profit science and technology institutions	Innovation Policy
Increasing support for not-for-profit science and technology institutions	Innovation Policy
Acceleration of tax credit devolution (PIS/COFINS)	Tax Policy
Broadening of the simplified tax regime for individual entrepreneurs (MEI)	Tax Policy
Broadening of the simplified tax regime for SMEs (Simples Nacional)	Tax Policy
Deferral of tax collection (PIS/COFINS)	Tax Policy
Establishment of sectoral tax regime for broadband (REPNBL-Redes)	Tax Policy
Establishment of sectoral tax regime for the defense industry (RETID)	Tax Policy

Establishment of sectoral tax regime for the computer industry (REICOMP)	Tax Policy
Establishment of sectoral tax regime for ports (REPORTO)	Tax Policy
Establishment of sectoral tax regime for semiconductors industry (PADIS)	Tax Policy
Establishment of sectoral tax regime for schools (PROUCA)	Tax Policy
Reduction of payroll taxes	Tax Policy
Temporary reduction of the Tax on Manufactured Goods (IPI) on capital goods	Trade Policy—EP
Adoption of new national "how-to export" plan	Trade Policy—EP
Adoption of new nomenclature for services trade	Trade Policy—EP
Adoption of new rules for export credit insurance	Trade Policy—EP
Adoption of new rules for export financing interest rate equalization (PROEX)	Trade Policy—EP
Adoption of new rules for the export guarantor fund (FGE)	Trade Policy—EP
Adoption of new rules for export-led companies' tax suspension	Trade Policy—EP
Devolution of export-related tax credits	Trade Policy—EP
Elimination of residual taxation on exports (REINTEGRA)	Trade Policy—EP
Establishment of a National Export Strategy	Trade Policy—EP
Establishment of an SMEs export financing fund (FFEX)	Trade Policy—EP
Expansion of financing for trading companies (ACC)	Trade Policy—EP
Expansion of trade finance (PROEX)	Trade Policy—EP
Implementation of the Istanbul Convention (ATA Carnet)	Trade Policy—IA
Elimination of temporary duty suspension to integrated systems	Trade Policy—IA
Elimination of temporary duty suspension for used and remanufactured goods	Trade Policy—IA
Establishment of a new Automotive Regime	Trade Policy—IA
Expansion of standards enforcement powers (INMETRO)	Trade Policy—IA

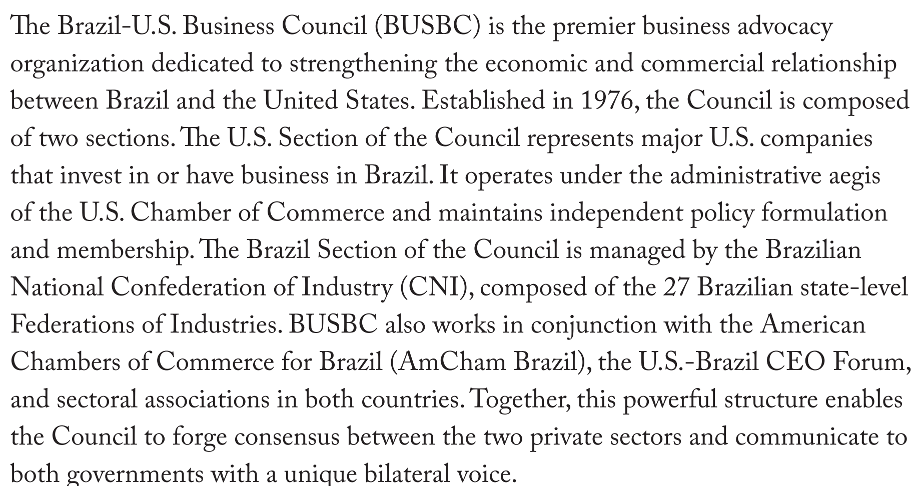
Fighting of compulsory certification infringing goods	Trade Policy—IA
Fighting of false declaration of origin	Trade Policy—IA
Fighting of fraudulent trade-related practices	Trade Policy—IA
Fighting of intellectual property infringing goods	Trade Policy—IA
Fighting of underinvoicing	Trade Policy—IA
Hiring of additional trade remedies investigators	Trade Policy—IA
Implementation of the Buy Brazilian Law	Trade Policy—IA
Implementation of trade remedies-related anti-circumvention rules	Trade Policy—IA
Increase in compulsory certification requirements	Trade Policy—IA
Increase in import tariffs within the WTO-allowed "policy space"	Trade Policy—IA
Reduction of trade remedies cases investigation time frame	Trade Policy—IA
Use of provisional measures in trade remedies cases	Trade Policy—IA

* Includes both August 2011 original measures and further additional measures. Nonexhaustive list.

EP—Export Promotion

IA—Import Administration

About Us



The Brazil-U.S. Business Council (BUSBC) is the premier business advocacy organization dedicated to strengthening the economic and commercial relationship between Brazil and the United States. Established in 1976, the Council is composed of two sections. The U.S. Section of the Council represents major U.S. companies that invest in or have business in Brazil. It operates under the administrative aegis of the U.S. Chamber of Commerce and maintains independent policy formulation and membership. The Brazil Section of the Council is managed by the Brazilian National Confederation of Industry (CNI), composed of the 27 Brazilian state-level Federations of Industries. BUSBC also works in conjunction with the American Chambers of Commerce for Brazil (AmCham Brazil), the U.S.-Brazil CEO Forum, and sectoral associations in both countries. Together, this powerful structure enables the Council to forge consensus between the two private sectors and communicate to both governments with a unique bilateral voice.

Vision

A barrier-free bilateral trade and investment relationship between Brazil and the United States that contributes to a lasting partnership with decisive influence in world politics and global governance.

Mission

Foster understanding among the private and public sectors in Brazil and the United States to maintain and advance trade and investment between both countries through free trade, free markets, and free enterprise.