



Brazil's Insertion in the Global Economy in Challenging Times

EXECUTIVE SUMMARY

As the rhetoric of protectionism gains ground throughout the industrialized world, Brazil is going in a surprisingly different direction. Traditionally one of the world's most closed economies, Brazil sees a unique opportunity to deepen its engagement with the global economy through trade and multilateral cooperation: a centerpiece of its effort to deal with the consequences of a deep and long recession. Greater openness, however, will require greater productivity and competitiveness. As a middle-income country, Brazil has "graduated" from the World Bank, making it more difficult to find financing to improve infrastructure and stimulate economic growth. Brazil's participation in the New Development Bank offers one solution, and the Temer administration has also proposed a number of domestic reforms intended to improve the business environment and spur investment. The challenge for Brazil will be, as Secretary of International Affairs Marcello Estevão confirmed, to win the political necessary to translate these policy ideas into concrete actions.

- Introduction:** Ambassador Anthony Harrington, Chairman, Brazil Institute Advisory Board
- Keynote:** Marcello Estevão, Secretary of International Affairs, Brazilian Ministry of Finance
- Panelists:** Monica Baumgarten de Bolle, Visiting Fellow, Peterson Institute for International Economics
Teresa Ter-Minassian, Former Director, Fiscal Department, International Monetary Fund
- Moderator:** Anna Prusa, Program Associate, Brazil Institute

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5th Floor, Woodrow Wilson Center

On trade, Brazil is swimming against the global current: while political leaders in the developed world push back on globalization and advocate protectionism, Brazil sees a unique opportunity to open up its economy, one of the world's most closed. As **Anna Prusa**, Program Associate at the Brazil Institute, noted as she opened the conversation, Brazil's neighbors in Latin America have demonstrated a similar interest in openness and multilateral cooperation. Earlier this month, representatives of Mercosur and the Pacific Alliance met to discuss a trade agreement between the two blocs, which together represent nearly all of the region's major economies. This is just one effort of many supported by the new government of President Michel Temer to foster growth through increased global ties.

Ambassador Anthony Harrington, Chairman of the Brazil Institute Advisory Board, highlighted the important role that Washington will play in defining this new global trade landscape, despite the uncertainty

that surrounds President Trump's trade policy. While he advocated protectionism on the campaign trail and withdrew the United States from the Trans-Pacific Partnership (TPP) on his first day in office, his administration has yet to lay out a more comprehensive direction on trade. That said, countries that have long looked to the United States for leadership on trade are now looking to other partners as well as to themselves: last month, the Chilean government hosted a summit in Santiago with the remaining members of TPP along with China, Colombia, and South Korea to discuss the possibility of continuing negotiations on a megaregional trade deal without U.S. involvement.

In a similar vein, Harrington indicated that Brazil is also moving away from protectionism, seeking to initiate or conclude trade agreements with Mexico, the European Union and, as previously mentioned, the Pacific Alliance. Citing a recent interview given by Brazilian Deputy Foreign Minister Marcos Galvão, he said that there is a "rare moment of consensus in Brazilian society" with regard to the need for global integration to stimulate the country's economy. Harrington ended on a note of optimism, remarking that "despite the difficulties that Brazil now faces, I believe that the crisis can leave Brazil stronger if it results in a more open and competitive economy." While the crisis provides an important catalyst for reform, he cautioned, leaders must make sure to move beyond rhetoric toward taking effective action.

Marcello Estevão, Secretary of International Affairs at the Brazilian Ministry of Finance, deepened the discussion by providing an in-depth view of the issues of international trade, investment, and governance that have constituted his primary portfolio since joining the Brazilian government in late 2016. He began by characterizing Brazil's motivation for its international economic insertion: participation in global governance, he said, is a way to directly support the government's domestic agenda of structural reforms and inclusive growth. By engaging on international issues, therefore, Brazil can strengthen its domestic economy. This international engagement must necessarily include interaction with multilateralism which, while increasingly viewed with skepticism by other governments around the world, Brazil's current government embraces.



From left to right: Marcello Estevão, Anthony Harrington, Monica de Bolle, & Teresa Ter-Minassian (Wilson Center, April 17, 2017)

Estevão then highlighted his government's efforts to pass reforms aimed at increasing productivity in the economy. For several years, productivity growth in Brazil has either been stagnant or negative, clearly showing that the "productivity problem" experienced by developed countries is also present in places like Brazil. To address this issue, Brazil hopes to improve its business environment, thereby simplifying bureaucratic processes and encouraging foreign investment. The four methods through which the government seeks to enact these changes are pension reform, tax reform, labor reform, and fiscal reform.

Pension reform, part of which has already been implemented through the spending ceiling passed by Congress last December, would improve difficult macroeconomic conditions and allow for microeconomic reforms to take place. Tax reform has been particularly requested by the foreign business community, who find the complicated nature of the Brazilian tax system a barrier to investing in and engaging with the country's market. As pension reform remains the government's primary priority, no concrete tax reform policy has yet been proposed. A labor reform under consideration aims to make regulations for employers more flexible as part of a larger rethinking of Brazilian labor relations that will extend past the end of the current administration in December 2018. Fiscal reform would promote efficiency and quality of public expenditure, and reexamine bureaucratic processes surrounding firm creation and bankruptcy, shortening the large amount of time currently required for both.

Shifting from the domestic arena to his work abroad, Estevão emphasized Brazil's commitment to multilateralism by outlining the country's commitment to international financial institutions and organizations. He began with the G20, stating that Brazil is an active member of the group with a strong voice in discussions about international economic and financial cooperation. As a part of the G20, Brazil is in line with the latest financial sector regulation and has constructed a modern domestic financial market. The strength of the Brazilian banking system and its oversight mechanisms have been demonstrated by their resilience in the face of the current recession, the worst in the country's recorded history. Estevão also echoed and fully supported the interview given by Deputy Foreign Minister Marcos Galvão, reiterating the government's aim to integrate more fully into international trade flows. He emphasized that in interactions with many multilateral organizations, both inclusive and sustainable growth is and should remain a top priority.

Turning to Brazil's engagement with the International Monetary Fund (IMF), he mentioned that Brazil leads one of 24 constituencies and is a key participant in the

development of the IMF agenda. He laid out Brazil's main priorities at the IMF as the following: ensuring sustainable development; creating new tools to detect and avoid systemic risk and crisis; promoting global financial stability; developing a wider safety net than is currently available; and capacity building for both Brazil and other emerging markets. Estevão also reiterated a longstanding Brazilian goal at the IMF: governance reform. He acknowledged that Brazil and other emerging markets are still underrepresented on the Executive Board and expressed hope for the success of quota reform currently planned for 2019.

"Despite the difficulties that Brazil now faces, I believe that the crisis can leave Brazil stronger if it results in a more open and competitive economy."

- Ambassador Anthony Harrington

Estevão characterized Brazil's relationship with the World Bank as a symbiotic partnership due to its longstanding adherence to the Bank's mission and the integrated "country partnership" between Brazil and the Bank that will come before its Executive Board this year. The partnership will directly support Brazil's domestic agenda by recentralizing its interaction with the World Bank and redirecting loans previously made directly to states and municipalities to the federal government. The federal government will then distribute the money in the form of grants to those states and municipalities that meet pre-specified policy goal. According to Estevão, the new arrangement will help Brazil relieve state-level financial problems and circumvent the inefficiencies in state and municipal governments that often present obstacles to doing business. In addition, he discussed a partnership between the Brazilian Development Bank (BNDES) and the World Bank to encourage private investment through infrastructure bonds in an attempt to "crowd in...not crowd out." He also emphasized the governments continued financial contribution to the International Development Association (IDA) despite the current recession. Estevão acknowledged, however, that Brazil's rising level of development has largely caused it to "graduate" from the World Bank, making it difficult to receive infrastructure investments critical to clear developmental bottlenecks, stimulate growth and improve economic productivity and competitiveness.

It was to fill this gap in infrastructure investment to middle-income emerging markets that Brazil, Russia, India, China, and South Africa created the New Development Bank (NDB). According to Estevão, who currently

serves as the Chairman of the NDB's Board of Directors, the Temer government fully supports the NDB and values the institution for its lean organizational structure, its specific mission, and its egalitarian governance arrangement in which Brazil participates along with the other four founding members. The NDB provides loans in local currencies, focuses on sustainable infrastructure, and will sign its first loan to Brazil in April 2017 to finance a wind power project jointly with BDNES. The NDB plans to partner with other multilateral investment institutions like the Inter-American Development Bank, the Andean Development Corporation (CAF), and the World Bank in order to develop institutional knowledge on multilateral investment best practices. Moving forward, Estevão says Brazil would like to incorporate new members into the Bank, maintaining an inclusive structure that will diversify both capital and lending.

Estevão then discussed Brazil's relationship with the Organization for Economic Co-operation and Development (OECD), which he described as active and mutually beneficial. Among the non-member partner countries of the OECD, Brazil is the one most involved in the organization's working groups. Estevão mentioned that the Ministry of Finance hopes to lead an effort to apply for full membership soon, which OECD officials appear to support. A stronger relationship with the OECD, he said, will build upon Brazil's past experience adhering to international best practices, enhance Brazil's voice in international economic decision-making, help return Brazil to investment-grade status, and allow it to influence the organization's governance.

"The big issue is how to integrate trade policy reforms...with efforts to conclude important trade negotiations."

- Marcello Estevão, Secretary of International Affairs, Finance Ministry

Finally, he turned to the subject of trade, highlighting that Brazil is the fourth most closed economy to international trade in the world, and the first among middle-income countries—a distinction he called "simply not good enough." He also pointed out that Brazil has the highest average applied import tariff among all emerging or developed economies and that from 2013-2016 Brazil was the world leader in the application of anti-dumping measures. He argued that this closure stems from an "antiquated" mercantilist view in which protectionism is seen as defending jobs and growing the economy, but that this manner of thinking no longer works for modern Brazil. The Ministry of Finance

will use its vote in the Chamber of Foreign Commerce (CAMEX) to scrutinize each anti-dumping measure considered, serving as the "guarding of the interest of the average voter" by ensuring that those that would hurt the domestic economy are not adopted. The economic closure created by these and other barriers-to-trade decrease productivity and prevent Brazil from catching up to more developed economies.

Looking forward, Estevão emphasized the importance of transforming these policy ideas into concrete action, particularly by convincing other government agencies and Congress of the necessity of reform. In particular, he wants to conclude ongoing trade negotiations and work with partners in Mercosur to rethink tariff regimes. He highlighted that a recent drop in Credit Default Swap (CDS) spreads demonstrates a reduction in international risk aversion toward Brazil as a result of the government's reform agenda. He argued that this risk aversion will continue to decline as more reforms are proposed and passed.

Concluding his remarks, Estevão underscored the importance of Brazil's current moment as an opportunity for change that should not be wasted. Making reference to the 2017 IMF Spring Meeting, which Estevão attended during his visit to Washington, he reiterated Brazil's commitment to international cooperation. Multilateralism, he said, is an evolving concept that Brazil has an active role in shaping, and is a necessary tool for achieving its ambitious domestic agenda.

Teresa Ter-Minassian, former Director of the Fiscal Department at the International Monetary Fund, opened her remarks by stating that Brazil shows a real commitment to openness. She argued that the Brazilian government's agenda for domestic structural reform needs to be accompanied by continued and strengthened efforts to promote the country's integration into the global economy. According to Ter-Minassian, a recent IMF publication showed that increased trade and financial openness have been positively correlated with growth acceleration in recent decades and help moderate the impact of external shocks on growth.

Looking at the Brazilian government's response to trade openness, Ter-Minassian said that there have been significant improvements in performance by the main financial and non-financial federal enterprises, including BDNES, Banco do Brasil, and Petrobras; as well as improvements to the domestic regulatory environment for infrastructure investment. Although the federal government's reform agenda is very ambitious and has been buffeted by fast-moving developments in the ongoing corruption investigations, Ter-Minassian believes that the government's efforts will pay off in the medium term because they are already shifting the attitude of the Brazilian



Panelists and audience at “Brazil’s Insertion into the Global Economy in Challenging Times” (Wilson Center, April 17, 2017)

public. After years of interventionist policies, Brazilian society needs to hear a new message of openness, of market-based economy with attention to social inclusion and the environment, according to Ter-Minassian.

Ter-Minassian also insisted that increasing trade integration should remain an important part of the government’s reform agenda – not only in terms of reducing the import tariffs, but also the less visible non-tariff trade barriers, including the excessive use of anti-dumping actions. At the same time, the government should reduce transport and logistics costs and pursue trade friendly tax policies in order to facilitate trade. Ter-Minassian maintained that a successful pursuit of this agenda will certainly have important payoffs in terms of increasing productivity, easing Brazil’s insertion into global value chains and helping to ensure a continued flow of FDI.

The former senior IMF official stressed that Brazil is the only country that can effectively lead a process of greater regional integration in Latin America, an appropriate response to possible protectionist trends in the United States and perhaps in Europe. She highlighted that while regional integration is important, it’s also important to deepen trade ties with other advanced countries, emerging markets, and dynamic low-income economies that remain committed to free trade. Ter-Minassian concluded that Brazil can also act within the various multilateral trade and financial forums in which it has an important voice to promote global integration, and that both Brazil and the global economy would benefit from the vigorous pursuit of such a stance.

Monica de Bolle, Visiting Fellow at the Peterson Institute for International Economics, divided her presentation in three parts. She opened by discussing the importance of trade openness for enhancing productivity and enhancing growth. She also emphasized that

opening the economy would signal a path forward to dealing with other corruption-related issues that have overwhelmed Brazil for a very long time.

In the second part of her presentation, de Bolle highlighted the ways in which Brazil could move beyond tariffs by reducing trade barriers. Brazil still has extremely high average tariffs rates. Citing a 2014 report, de Bolle argued that Brazil’s adoption of local content requirements after the financial crisis hampered productivity and created distortions in the economy. The current administration sees these local content requirements as impediments to trade, and thus is looking to make progress in this area. Furthermore, de Bolle asserts that the government is looking into intellectual property rights, regulatory convergence, and customs procedures as measures of trade facilitation.

The third portion of de Bolle’s remarks focused on financial sector reforms and how they can help with trade. De Bolle noted that the relationship between financial development and trade shows that financially developed countries have better prospects for trade and for building up export-powerhouses. For a long time, the Brazilian government focused on the local market rather than the external market, which caused Brazil to lag behind other emerging markets. Credit market segmentation, another problem in Brazil, contributed to a situation where companies lack access to financing and are unable to use their potential to become export powerhouses. De Bolle did acknowledge that there have been recent developments in this area with financial sector reform initiatives. De Bolle concluded that although the Brazilian government currently has in place an openness agenda, it needs support from the private sector for advances in this area to occur.

Q&A Session

A dialogue involving the audience—of approximately thirty people—followed the panelists' remarks.

Q: What should be the goals for Brazil during the spring meetings [of the IMF and World Bank]? What do you hope to achieve here in Washington this week?

Marcello Estevão stated that goal for Brazil during the spring meetings this year is active participation in the debate, rather than the promotion of a specific agenda. As a member of the international community, representatives for Brazil intend to debate issues like the role of multilateralism and the importance of trade to growth. They will meet the countries and their constituents at both the IMF and the World Bank, listen their complaints and discuss how Brazil is going to better defend those interests and institutions.

Q: How is the World Bank re-centralization going to impact Brazilian states and how much finance will be cut as a result?

Marcello Estevão noted that the money from the World Bank program will flow to the individual states through grants provided by the federal government, shielding states from having to borrow. One of the major problems local governments have in interacting with international organizations is the difficulty municipalities and states face in repaying their debt. The shift toward federal grants is meant to support municipalities and states, to ensure they continue to have access to the resources and programs that they need, despite their fiscal constraints. In order to make this a reality, the federal government has designed a centralized policy that will take between three to five years to implement and is related to the modernization of the tax system in Brazil.

Q: In terms of anti-dumping measures, what is the goal of the government and why is it considered a scandal in Brazil?

Marcello Estevão stated that as an economist, he does not understand the protectionist argument and does not support the current policy: "A country that exports a lot is a country that imports a lot. A country that grows a lot is a country that can borrow at low cost to be able to finance its production. A country that grows a lot is a country that doesn't have barriers to how companies can decide how to fund an operation." Estevão stressed that the role of the Ministry of Finance is look at every anti-dumping proposal and reflect on whether it makes sense for the Brazilian economy,

and that he takes this role very seriously. He stated he intends to review all anti-dumping measures proposed.

Monica de Bolle also offered insight into Brazil's anti-dumping measures. She noted that reviewing anti-dumping measures and considering scaling back local content requirements—or any kind of non-tariff barrier—not only impacts productivity and growth, but also impacts the cost of living. She maintained that these measures actually do add to the costs of goods, which are much more expensive in Brazil for this reason. De Bolle stressed that Brazil has a lot of capacity to do reduce trade barriers through COMEX, which studies how they have affected the Brazilian economy. A lot more of this work needs to be done. She concluded that the way to bring the message to audiences in Brazil is to make them understand their cost of living is considerably higher because these measures are in place.

Q: What support does the government have for a policy of openness? How much can be accomplished before the next election?

Marcello Estevão pointed out that the government needs support from the private sector, which has been at best divided on this issue. He argued that Brazil cannot continue with the current policy. Instead Brazil should find other options, such as modernizing its relationships with the rest of the world, rethinking trade policy, and moving beyond using trade negotiations as an excuse for inaction. Estevão claimed that Mercosur is part of this discussion and that Brazil has a lot to learn from the Pacific Alliance.

Estevão maintained that susceptibility to foreign import crises are a concern, but noted that the country in Latin America with the worst recent economic crisis, excluding Venezuela, was Brazil. He contended that this is because Brazil is one of the most closed economies in Latin America. Overall, Estevão argued that the benefits of openness outweigh the costs.

Q: What are the prospects for dialogue between Mercosur and the Pacific Alliance or Mexico?

Marcello Estevão argued the "prospects are great," and that Brazil is looking to get closer to both Mexico and the Pacific Alliance. He noted that there is ongoing cooperation, including a service agreement with Peru that involves the procurement of government purchases. Estevão stated that Brazil's relationship with its partners in Latin America is something the Minister of Foreign Relations takes very seriously.

Q: Brazil is seeking to join or get closer to the OECD, something Brazil decided not to do in the past. Why is Brazil focusing on this now?

Marcello Estevão suggested that Brazil might have avoided falling so deeply into crisis if it were part of the OECD. As a member of the OECD, Brazil would have had to abide by a certain rules of governance. He believes the OECD still welcomes Brazil's entrance into the organization. The Brazilian government is currently studying the requirements for entry, although he recognized that the government may not be positioned to enact all of the reforms in the short-term, given the current economic and political situation. However, he argued that being part of international organizations, including the OECD, would be beneficial for Brazil's success. Not doing so would be tantamount to shortchanging the country.

Q: Could there be a government office that would serve as a "one-stop-shop" for foreign investors to understand Brazilian regulations?

Marcello Estevão agreed that having a government office to promote investment would be a good idea. He noted that the administration is currently thinking about ways to improve the business environment that facilitates the understanding of Brazilian regulations to foreign investors.

Q: Given the extensive fiscal, labor, tax and pension reforms proposed, how much does the current government actually expect to accomplish?

Marcello Estevão affirmed that government expects to accomplish everything on its reform agenda, even given the time constraint. Currently, the administration is negotiating social security reform with Congress. After this reform is passed—whether in the original text or with modifications—the labor reform bill will be the next to be voted on. He stated that the government will continue sending reform bills to Congress until the end of its term [in 2018]. *Estevão* argued that trade reform should be a priority, given that it is the biggest problem Brazil currently faces.

Q: Does a closed trade and political environment encourage corruption?

Marcello Estevão noted that Brazil is not an outlier in Latin America in terms of corruption. Brazil stands out from other countries in the region in that it there is a great movement of Brazilian society to fight corruption, which the country is currently doing with ongoing investigations. *Estevão* acknowledged that Brazil's more limited participation in international institutions may have, at the margins, contributed to corruption. However, he highlighted Brazil's engagement with the World

Bank, IMF, Inter-American Development Bank, World Trade Organization, and other international forums.

Monica de Bolle pointed out that there is some incipient research on the linkage between corruption and trade. She contended that, with respect to Brazil, it is an issue of attitudes. A closed economy and opaque measures—such as the local content requirement—will reduce transparency within the economy, which in turn lays the groundwork for corruption. *De Bolle* agreed with *Estevão* that corruption is not unique to Brazil. The current push towards transparency and accountability is an unusual, but welcome process for Brazil. She argued that greater openness and less opaqueness should accompany this process. *De Bolle* concluded by stating that openness will probably not eliminate corruption, but it is certainly a step in the right direction.

Teresa Ter-Minassian, like the previous speakers, agreed that there is a correlation between the degree of corruption and openness. Corruption in Brazil has long roots, she argued, particularly in campaign financing and political party fundraising. *Ter-Minassian* maintained that although greater openness is not going to be a panacea for the problem of corruption in Brazil, current Lava Jato investigation and others will have a very important deterrent effect. She remarked that corruption will never be eradicated, but that it can be substantially reduced.



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