

Integrating to grow

a proposal for trade liberalization

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Centro de Estudos de
Integração e Desenvolvimento

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PREFACE

All the countries that, since World War II, have managed to escape the middle-income trap and become rich have done so by integrating into world trade. Not all countries that opened up to trade have developed, but all countries that have developed did so with significant trade integration with the rest of the world.

Brazil, on the contrary, remains with its back to the world – with a significant part of the industries and services limited to the domestic market (which is only 2% of the world market). The integration of Brazil into international trade will allow Brazilian companies to have the best technology and the most modern inputs that the world can produce. At the same time, our companies will be able to deliver better and cheaper products and services to Brazilian consumers.

The poorest and least organized segments of society pay the costs of the excessive protection granted decades ago by trade policy to local producers of goods and services. Reversing this situation to the benefit of the most vulnerable – and the majority – sectors of society is a central objective of trade liberalization.

Furthermore, in the 21st century, the absorption of information technology and the transition to the green economy are imperative. Brazil will not take these steps alone, which is a strong additional reason for trade liberalization.

The document, *Integrating to grow: a proposal for trade liberalization*, contemplates the main elements of a strategy for the international trade integration of Brazil, in a period marked by strong uncertainties in the global scenario. The international integration of the Brazilian economy becomes even more relevant in this scenario.

The document is comprehensive: it presents the positive effects of trade liberalization for society, while considering the need to adopt policies that mitigate potential risks of trade reforms.

By presenting this document to society and to candidates for elective positions, we want to contribute to nourishing the debate and fueling decision-making in a critical public policy area for the resumption of growth and the well-being of the Brazilian population, especially the most vulnerable ones.

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INTEGRATING FOR WHAT?

CINDES presents the document ***Integrating to grow: a proposal for trade liberalization***, with the objective of contributing to the public debate on why and how to deepen the insertion of the Brazilian economy in international trade.

Trade liberalization is a necessary, though not sufficient, condition to lift Brazil out of a long period – more than 40 years – of economic stagnation. The offer of cheaper and better-quality inputs and machines and equipment reduces production costs, facilitates access to more advanced technologies, promoting productive efficiency and reducing the final prices of products for the consumer. **Greater competition in the domestic market promotes the reallocation of resources in favor of the most efficient firms, increasing the overall productivity of the economy.**

A more competitive environment will contribute to promoting efficiency gains and productivity growth, which will result in lower consumer prices, leading to increased social well-being and reduced poverty. Social welfare must be the ultimate objective of any trade policy.

Brazil is an outlier when it comes to the level of tariff protection granted to industrial products. **In 2020, only nine countries in the world had higher average import tariffs for non-agricultural products than Brazil.** There is no economic or social criterion that justifies Brazil's presence in this small group of countries endowed with high tariff protection for industrial goods.

Another characteristic of the protection structure in Brazil is its lack of selectivity. The country has high tariffs for inputs and capital goods, compared to the rest of the world, but also for products that are relevant to citizens, particularly young people, harming their social and professional insertion.

The resilience of the trade liberalization proposal in Brazil

The evolution of national and international contexts does not call into question the proposal for trade liberalization in a country like Brazil. On the contrary, it allows adding new arguments in its favor:

- Globally, there has been no significant increase in the levels of trade protection and, where it occurs, the increase in protectionism takes place on a basis of very low tariffs, resulting, in most countries, from long processes of liberalization of trade flows – something that did not happen in Brazil.
- Most developing countries continue to seek greater international integration in their development strategies.
- Trade liberalization can represent an insurance policy, expanding the sources of supply of inputs and raw materials for domestic producers and reducing their dependence on oligopolized sectors that today dominate the domestic market with scarce competition.
- The world industry will operate a double structural transition in the coming years – digitization and decarbonization. The participation of Brazilian industry in this process requires the reduction in costs and obstacles to the international trade of goods and services.
- The reshaping of value chains in the world can open up opportunities for the country. Taking advantage of these opportunities will depend on reducing obstacles to companies acting in accordance to the logic of value chains: import costs are one of the biggest obstacles to such integration.
- Last but not least, the traditional economic arguments in favor of trade liberalization – based on its positive effects on efficiency and productivity and on the real income of the poorest strata of the population – keep their validity for an economy like the Brazilian one.

The trade reform proposal

The reform proposal presented in the document aims to “normalize” Brazilian trade policy. In other words, to make the country stop being an outlier, in terms of the degree of protection granted to domestic producers, bringing it closer to that prevailing in most countries with an equivalent level of development.

The focus of the proposed reform is on the instruments used to manage imports of goods and services: tariffs, non-tariff measures, barriers to trade in services and trade negotiations.

Trade liberalization generates winners and losers. A second set of proposed measures is aimed at managing the costs and risks potentially derived from trade liberalization.

To these two sets of measures, the proposal adds a group of complementary policies, which attack the so-called “Brazil Cost”. **Trade liberalization should not be put on hold, waiting for the reduction of the “Brazil cost”.** But implementing the reforms that will lead to the reduction of these costs will guarantee better and greater results for the reform of trade policy.

A. Liberalization of trade in goods and services

- *the tariff reform*

A comprehensive tariff reform adopted from a strategic perspective must be announced in advance, have explicit and transparent criteria and be implemented gradually over four years, a period of time corresponding to a Presidential term.

The criteria that guide the tariff reform proposed here are: a) strongly reduce the tariff escalation that characterizes the protection structure; b) reduce the cost of imports of intermediate products and capital goods; and c) simplify the tariff structure, drastically reducing the number of tax rates for the import tax.

The tariff reform would be implemented over four years, at the end of which the Brazilian tariff would have only four tax rates: 0%, 5%, 10% and 15%.

The tariff reform must be accompanied by the following initiatives:

- End of the ex-tariff mechanism;

- Adherence to Plurilateral Agreements to eliminate tariffs in the WTO: ITA and Civil Aviation;
 - Accelerated tariff reduction for environmental capital goods; and
 - Review of the WTO bound tariffs, adapting them to the new tariff structure.
- *elimination or reduction of non-tariff measures*

In addition to tariffs, non-tariff measures play a relevant role as a limiting factor for international trade. Among the initiatives that can contribute to the reduction of import costs, the following deserve special attention:

- Conclusion of the Single Foreign Trade Portal with full operation of the New Import Process;
- Substantial reduction in the number of products subject to non-automatic import licensing;
- Regulation for the import of remanufactured products;
- Adoption of criteria for the assessment of public interest in the review of trade defense measures in force; and
- Support, in the WTO, efforts to update the multilateral rules on the granting of subsidies.

● *Liberalization of trade in services*

The fragmentation of the production process into international value chains has increased the importance of services in international product flows. The increasing aggregation of technology to the production of goods makes the competitiveness of products increasingly linked to the competitiveness of services. This trend only tends to increase with Industry 4.0 and the digitization of production.

The tax incidence on the imports of technical services in Brazil, essential for the incorporation of technology, varies between 41% and 51% of the value of the operation, representing a significant discrimination in relation to domestic providers that collect, on average, 18%.

The main proposals for reducing the costs of importing services include:

- Reduce the tax burden on the import of services, with the extinction of CIDE-Remessas;
- Avoid taxation on exports of services.

- *Trade negotiations*

The current context of uncertainties regarding the configuration of the international scenario does not facilitate the building of an ambitious agenda in the sphere of preferential negotiations. Despite this, **there are indications that regionalization movements may regain some traction, driven by the reorganization of supply chains.** Brazil should keep these movements on its radar, pragmatically defining an agenda of priorities:

- *Priorities:*

- Ratification of agreements already negotiated with the European Union and EFTA;
- Review of the MERCOSUL model in order to create conditions to promote trade liberalization that includes both autonomous and negotiated dimensions;
- Negotiating a free trade space in South America.

- *Initiatives with ongoing negotiations or with a pending expansion agenda:*

- Deepening of economic and trade relations with Latin America, especially with Mexico;
- Conclusion of ongoing negotiations with South Korea and Canada.

Despite the crisis of multilateralism, this instance of negotiation and production of rules should continue to be given priority by the new government.

B. Risk monitoring and mitigation policies

It cannot be ignored that trade reform brings with it risks that require attention and the mobilization of policies to mitigate them. Special emphasis is given here to the impacts on work and employment in the transition period, to possible effects on the environment and, in the current international context, to the functioning of supply chains.

● *Work and employment*

Liberalization is expected to produce winners and losers, the most protected sectors and the most inefficient firms tending to suffer the greatest impact from the process. Trade gains and their distributional effects are inextricably linked. To deal with these costs we propose:

- Assessment of impacts of the liberalization policy on employment;
- Re-adaptation of existing active professional retraining policies to the needs of mitigating the costs of opening up;
- Coordination between national and subnational entities; and
- Strengthening of horizontal social protection programs.

● *Sustainable development*

Trade reform is an opportunity to discuss the environmental and climate implications of such a policy reorientation, as well as ways to reconcile economic and environmental/climate efficiency objectives in the liberalization process.

In view of this, the following recommendations should be considered:

- a rigorous implementation of the country's environmental policy and legislation;
- inclusion of sustainable development commitments in trade agreements negotiated by Brazil; and
- engagement of public and private actors in the arenas of negotiating voluntary sustainability standards.

● *Supply chain vulnerability*

The **perception of risk associated with value chains intensified from 2020 onwards**, with the recovery of post-pandemic economies and then the invasion of Ukraine by Russia.

Several sectors of the Brazilian economy are already suffering the effects of this international scenario: automotive production, as well as other sectors dependent on access to semiconductors, have had their flow of operations affected, while agribusiness sectors face the risk of shortages – or increase in costs – of inputs such as fertilizers.

While avoiding simplistic solutions pushed by interest groups benefiting from new import substitution movements and recognizing that the management of risks associated with international value chains is a problem to be dealt with mainly by companies, it seems undeniable that this issue can require the adoption of public policy measures.

- Risk assessment for supply chains and cost-benefit analysis of government interventions

Ideas to be emulated in the country could be inspired by initiatives such as that of Australia, whose Productivity Commission conducted a careful assessment of the risks and vulnerabilities of the chains in which Australia participates, upstream and downstream.

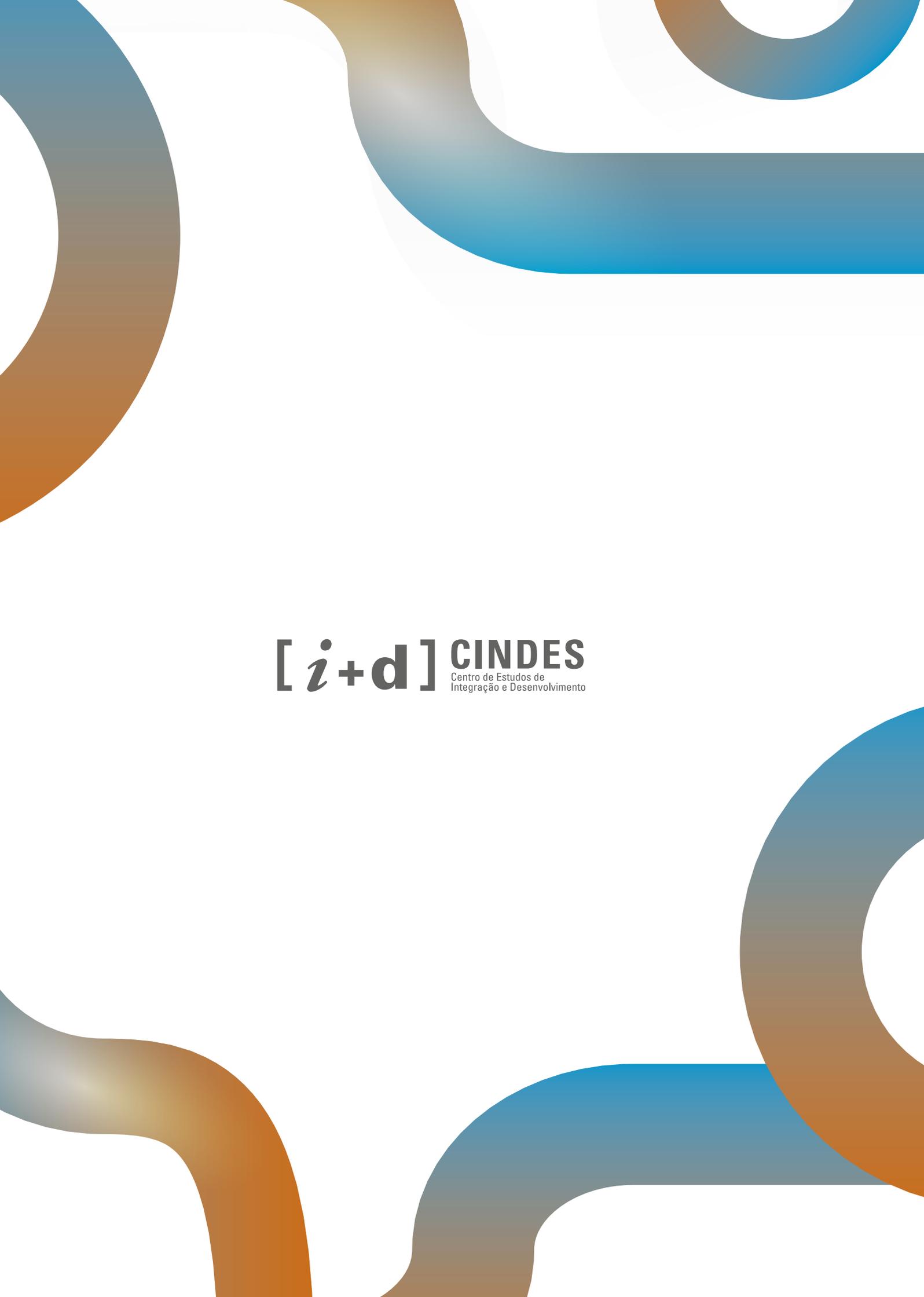
C. Complementary Policies

Realizing the full potential of trade reform depends on a broader set of public policies needed to improve the country's business environment and competitiveness.

Without intending to be exhaustive, and even less so, making trade liberalization conditional on the adoption of these measures, policy initiatives in several areas can contribute to generating the expected benefits of trade reform. They are:

- Accession to the OECD
- Pro-trade and investment tax reform
- Restoring export financing mechanisms
- Improved transport and logistics infrastructure

- Modernization of innovation policy
- Reform of the incentives policy of the Manaus Free Trade Zone



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