Untying the knots strangling Brazil's competitiveness

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There is strong international evidence that trade liberalisation and increased international integration are key elements of a successful growth strategy. Exposure to international competition, sourcing internationally and learning by exporting accelerates technological upgrading and fosters productivity growth. This column explains how three policy instruments are holding back competitiveness by limiting Brazil's ability to tap into the global pool of knowledge.

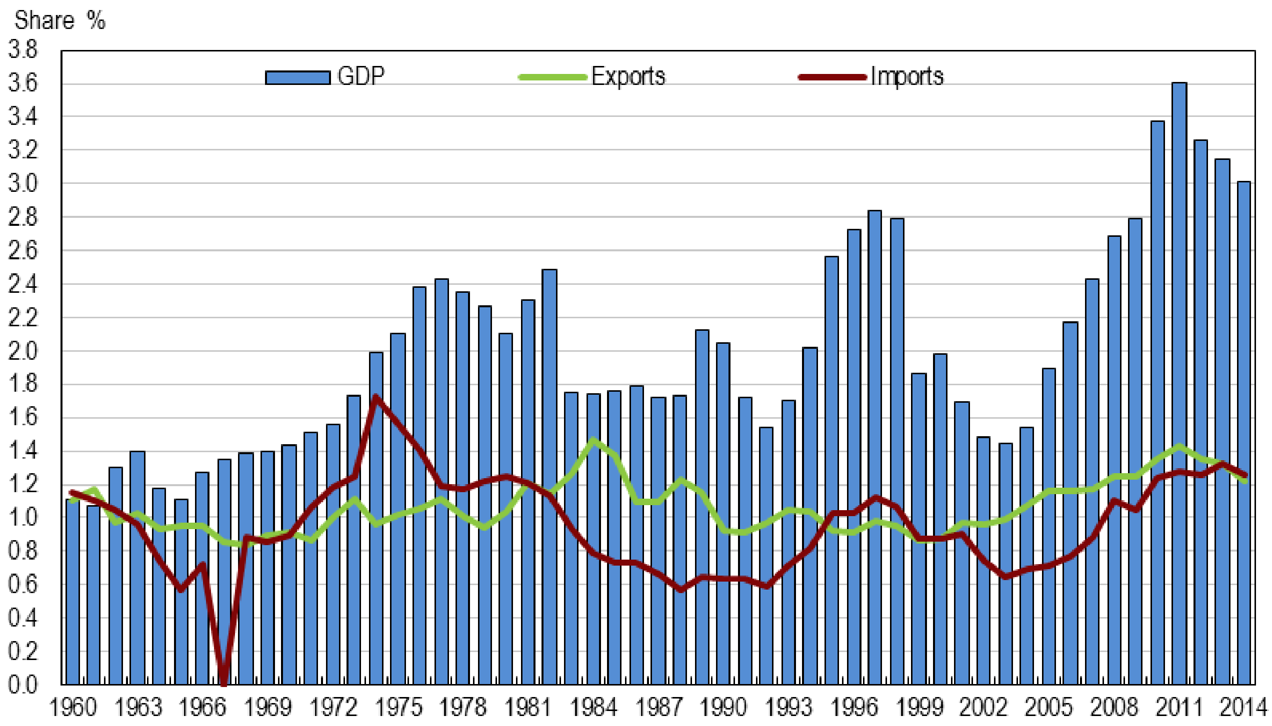
Despite a constitutional amendment in 2003 intended to exempt exports from indirect taxes, Brazilian exporters face tremendous hurdles in claiming back indirect taxes paid on intermediate inputs. Poultry exporters, for instance, estimate that the government owes them around 7% of the value of their exports on account of the several indirect taxes paid on inputs. After attempting to claim these credits for years, companies simply prefer to write off these amounts.

The competitiveness of industrial exports is suffering even more than that of raw and semi-processed goods on two accounts: higher rates are applied to products requiring more transformation and indirect taxes are cumulative. Indirect taxes on inputs embodied in exports put Brazilian producers at a disadvantage vis-à-vis foreign competitors who do not pay such taxes.

Brazilian exporters are also penalised by Brazil's high import tariffs, which are the highest among the BRICS countries for non-agricultural products (see previous post on Brazil: A tale of two industries or how openness to trade matters, March 22, 2016). Together with local content requirements that expand into an increasing number of sectors (oil, chemicals, motor vehicles, telecoms, health, etc.), they prevent Brazilian companies from sourcing at the lowest cost.

Advocates of trade protection often claim that protection raises the performance of domestic industry over time. Brazil's own experience in this area is sobering. There is no evidence that high levels of protection have spurred Brazil's exports, which have remained flat relative to GDP (Figure 1).

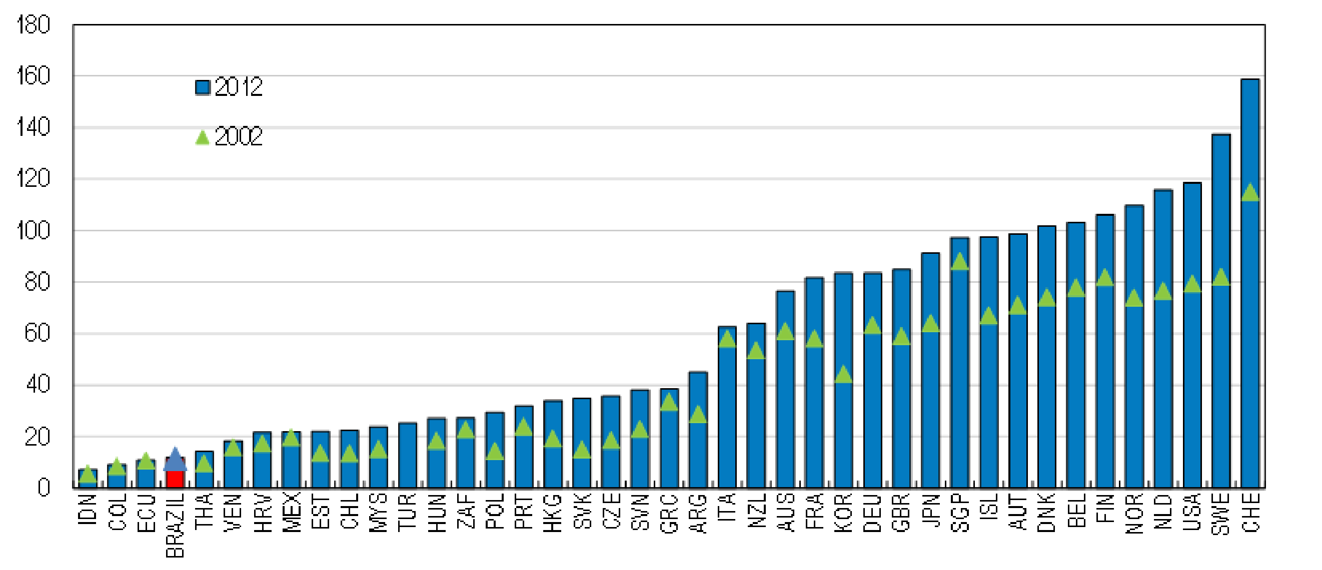
Figure 1. Brazil's share of world trade is low relative to its GDP
Share of exports and imports on world's total exports and imports, respectively



Source: **Secretaria de Comércio Exterior (SECEX) do Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC), World Bank Development Indicators.**

In fact, the share of manufacturing output in GDP has been declining for a decade and manufacturing productivity is low and stagnant (Figure 2).

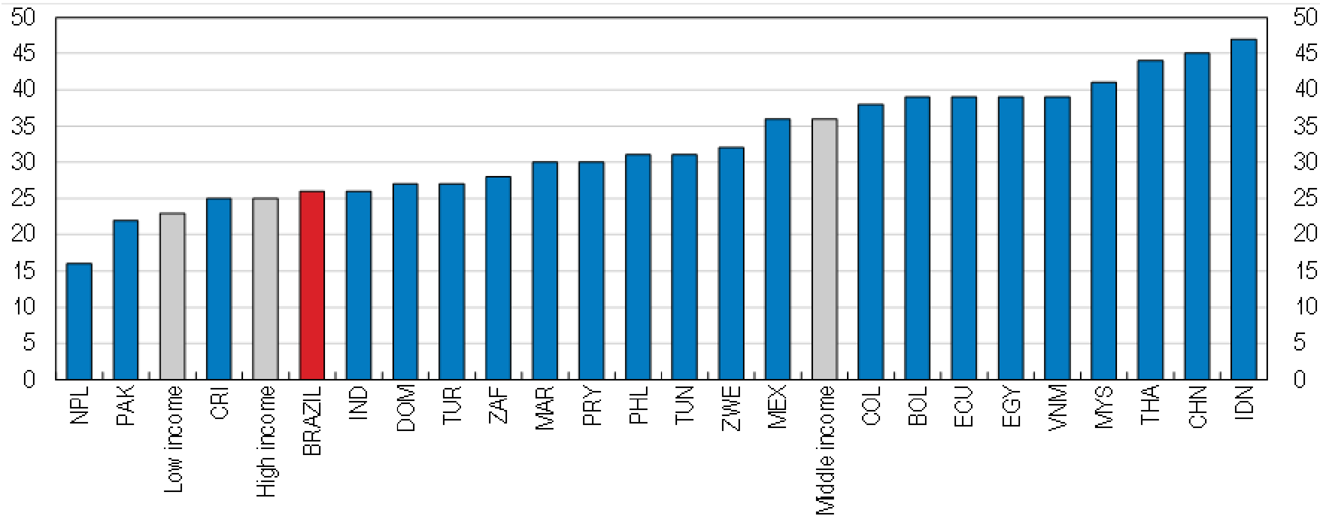
Figure 2. Manufacturing productivity is low and stagnant
Labour productivity in thousands of constant 2005 USD per employee



Source: **World Bank, ILO, IBGE.**

By international comparison, Brazil's industrial sector is small for a middle income country (Figure 3; OECD, 2015).

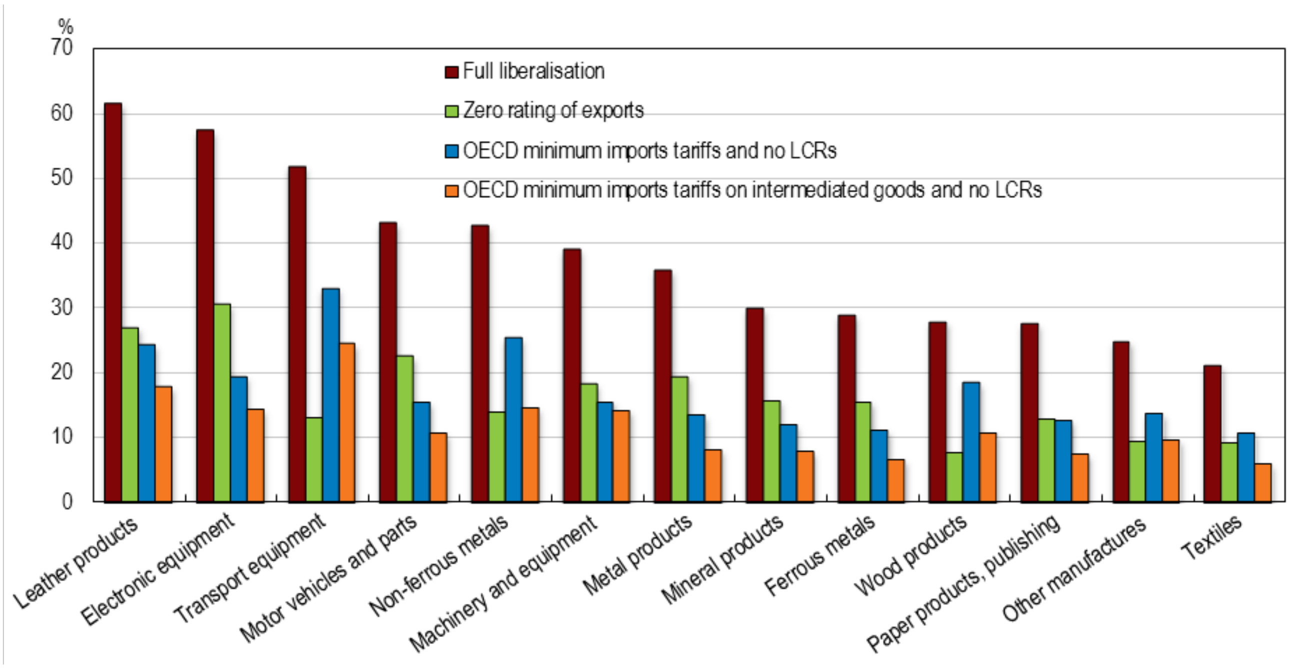
Figure 3. Brazil's industrial sector is small for an upper middle income country
Share of industry in total value added in middle income countries, in per cent, 2012



Source: **World Bank.**

In a recent study we attempt to quantify the effects of lifting these barriers to trade using the OECD Metro model, a computable general equilibrium model of the world economy. The simulation results suggest that reducing import tariffs and local content rules, and effectively exempting intermediate inputs from indirect taxes would boost Brazilian exports, production and jobs substantially. The largest gains would accrue in manufacturing, where exports of leather products, electronic and transport equipment, motor vehicles and non-ferrous metals would all increase by more than 40% (Figure 4). Job creation would be higher in lower skilled occupations, benefiting those at the lower end of the income distribution.

Figure 4. Largest Gains in Exports
Sectors with an increase in exports of at least 20%



The simulation results also suggest that these tax and trade policy reforms would bring clear efficiency gains to the economy: firms would be able to use a higher share of foreign intermediate goods and final goods would in turn be sold at lower prices, enhancing export competitiveness and benefiting Brazilian households.

Another result from our simulations is that it pays to go for a big push. The benefits of a wide-ranging trade liberalisation would far exceed those of partial reforms. Overall, getting rid of these barriers would enable Brazil to develop a stronger manufacturing sector and become much more integrated into the global economy.

Find out more

Araújo, S. and D. Flaig (2016), "Quantifying the Effects of Trade Liberalisation in Brazil: A Computable General Equilibrium Model (CGE) Simulation", *OECD Economics Department Working Papers*, No. 1295, OECD Publishing, Paris.

OECD (2015), OECD Economic Surveys: Brazil, OECD Publishing, Paris

More competition for better economic outcomes in France

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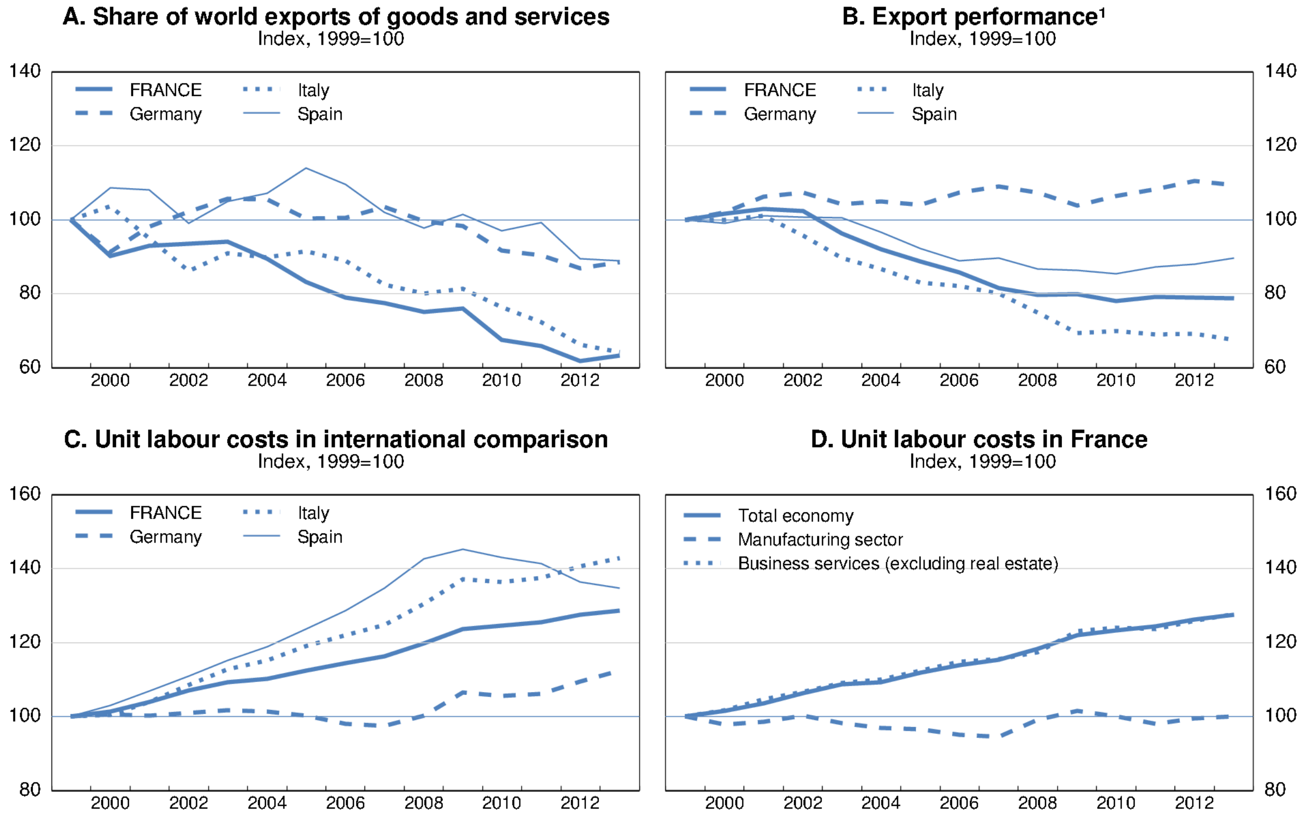
Strengthening competition would have positive effects on French competitiveness, employment, equity and well-being. The OECD (2015a) estimated that five sets of measures in the "Macron Law" – the reform of regulated professions, the extension of Sunday and evening trading, the opening-up of passenger coach transport, the simplification of redundancy rules and easier procedures for obtaining a driving licence – could potentially increase France's GDP by 0.4% over 10 years. Streamlining entry requirements in some professional occupations and easing entry conditions for micro-enterprises, as recently announced, would also be good moves. However, there is scope to go much further and increase synergies with labour market reforms (OECD, 2014, 2015a and 2015b).

Over the last decade, France's export market share losses have been slightly greater than those experienced by the other main euro area countries (Panel A). In particular, French export growth was relatively slow compared to its export markets before the global financial crisis in 2008 (Panel B). French wages have increased faster than labour productivity, and unit labour cost growth has exceeded the corresponding German rate (Panel C). This trend is mainly explained by developments in economic sectors that are partly sheltered from international competition (Panel D). Strengthening competition in those sectors would benefit all industries that use them as inputs in their production process and improve the cost-competitiveness of French exporting firms, their profit margins and investment capacities.

Changes in export market shares and unit labour costs



1.Difference between export growth and export markets' growth, in volume terms (with export markets as of 2010).
***Source*: OECD (2015), Economic Outlook 96 and Productivity databases.**

The OECD analysis highlights three main areas of reforms to improve competition, productivity and employment:

1. **Simplify the business environment.**

Streamlining administrative procedures, including the tax system and government support for firms, together with improving public procurement practices, would allow substantial productivity gains and growth. The guidelines issued by the OECD (2011) should be used to systematically review existing regulations from a competition perspective according to a set schedule, and measures should be implemented rapidly.

2. **Continue to open up regulated professions.**

For architectural, accountancy and legal services, barriers to entry and controls on practice in France were among the highest in the OECD in 2013. Streamlining entry requirements, opening further the capital ownership and increasing or lifting numerical quotas for selected professions would strengthen productivity and allow economies of scale and scope.

3. **Ease further retail regulations.**

The new rules governing urban commercial development and Sunday opening remain unnecessarily complex. Urban zoning rules are still a constraint for large stores, and heterogeneous Sunday openings' regulations distort competition and limit employment. Moreover, the sales of certain products, such as over-the-counter drugs, and the periods during which clearance sales can be held, are still tightly controlled.

Find out more:

Goujard, A. (2015), "Enhancing Competitiveness, Purchasing Power and Employment by Increasing Competition in France", OECD Economic Policy Papers, No. 14, OECD Publishing, Paris.
OECD (2011), "Competition Assessment Toolkit", OECD Publishing, Paris.
OECD (2014), "France, Les réformes structurelles : impact sur la croissance et options pour l'avenir", OECD Publishing, Paris.
OECD (2015a), "France, Évaluation de certaines mesures de la Loi pour la croissance, l'activité et l'égalité des chances économiques et perspectives de futures réformes", OECD

Publishing, Paris.
OECD (2015b), “OECD Economic Surveys: France 2015”, OECD Publishing, Paris.