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Brazilian Economic Isolationism and Its Consequences

Case Study

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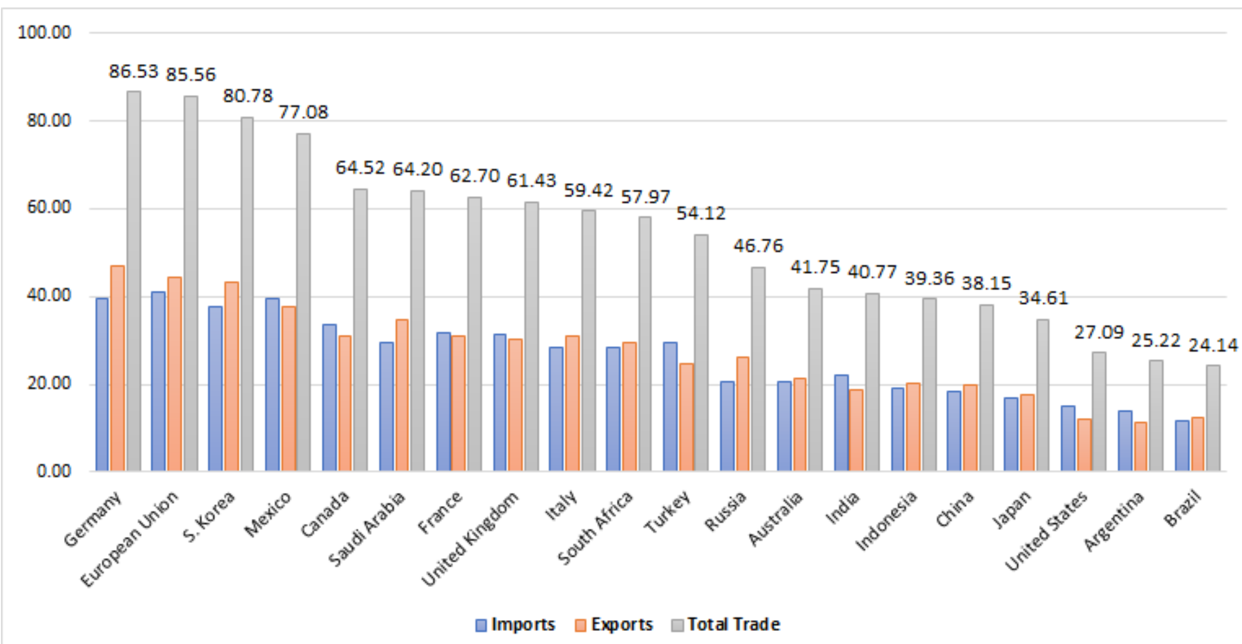
PROPERTY RIGHTS ALLIANCE

The role of international trade as a means of intensifying the division of labor and specialization worldwide, enabling countries to focus on their comparative advantages has been studied for a long time. More recently, the case of South Korea has shown that international trade affects technology absorption, facilitating human development, capital accumulation, and technological innovation.

In Brazil, the main strategy for industrialization since the past century has been the substitution of imports, which worked to industrialize the country in the short-term and then has distorted investments and ended up creating the "national champions", large national companies that had privileges granted by the government.

Compared to the other G20 countries, Brazil has the lowest trade openness (imports + exports) and therefore has the most isolated economy in the group.

TOTAL TRADE AMONG G20 COUNTRIES (% OF GDP)



Source: World Bank, 2017

The country has a much lower trade openness than the average of almost any group to which it belongs. For instance, Brazil is currently negotiating its membership to the Organization for Economic Cooperation and Development (OECD) and the country's trade openness is currently below half of the OECD's average rate.

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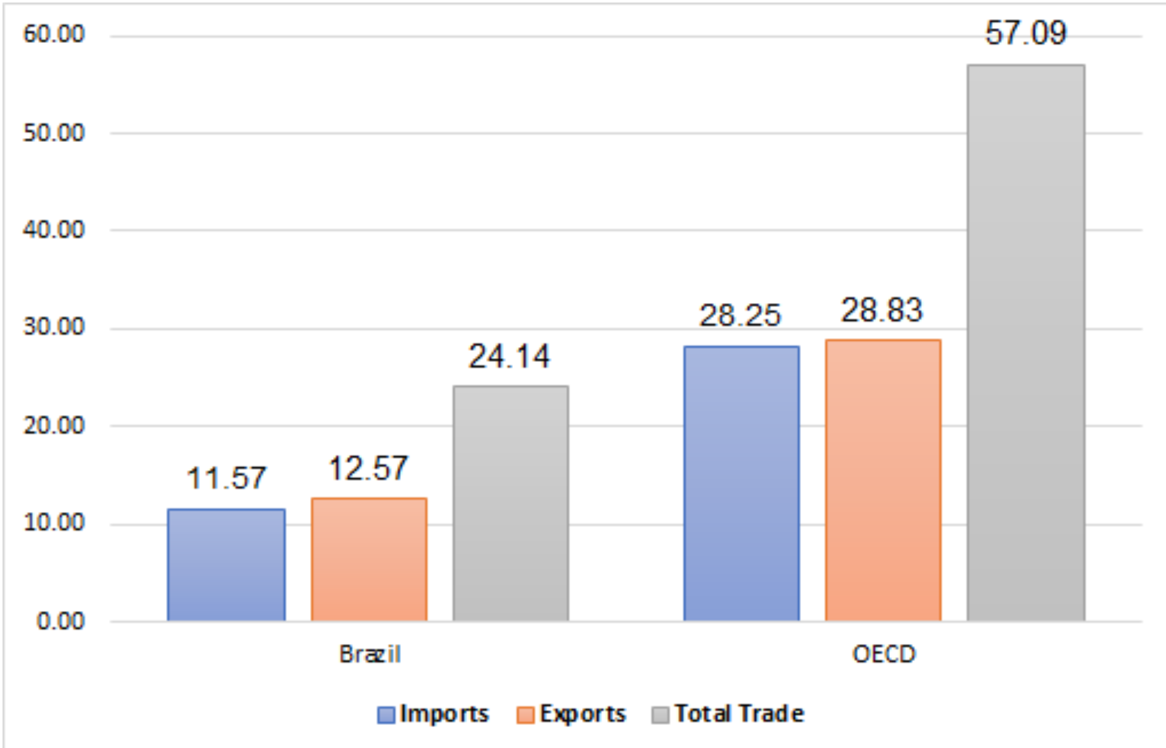
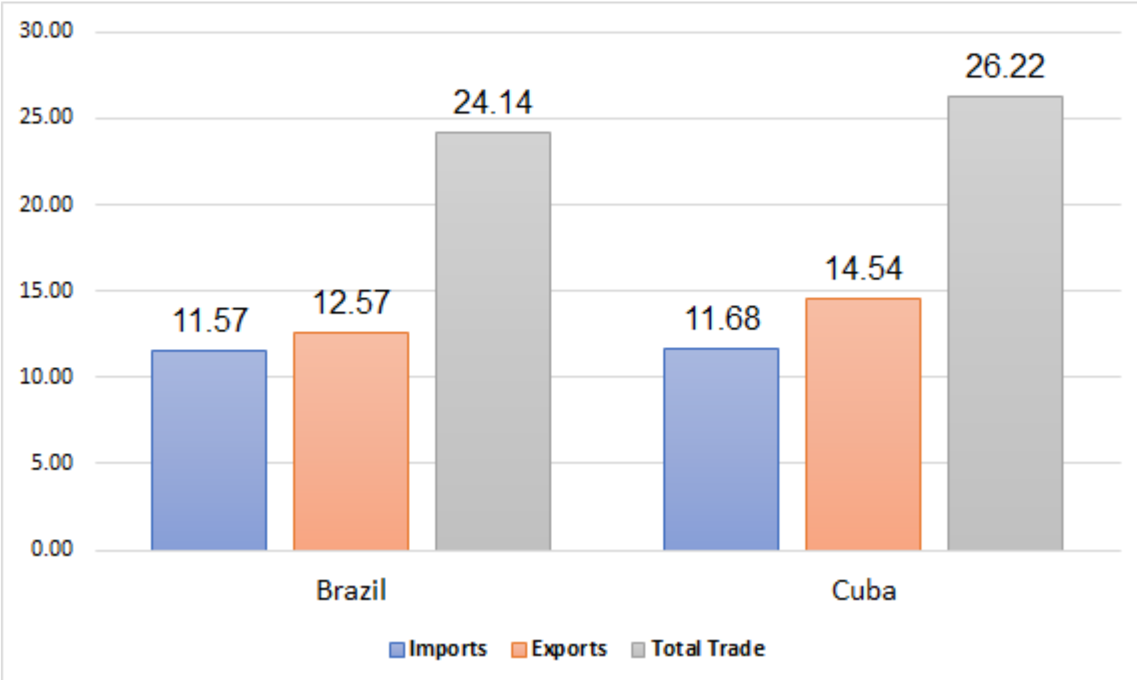
TOTAL TRADE: BRAZIL V. OECD (% OF GDP)



Source: World Bank, 2017

Brazil has a less globally integrated economy than Cuba, a country whose main complaint on the international scene has been the US embargo, which is in place since the 1960s. The country imports and exports relatively less than Cuba, highlighting that the South American country has an unorthodox trade policy that represents a self-embargo on trading with the rest of the world.

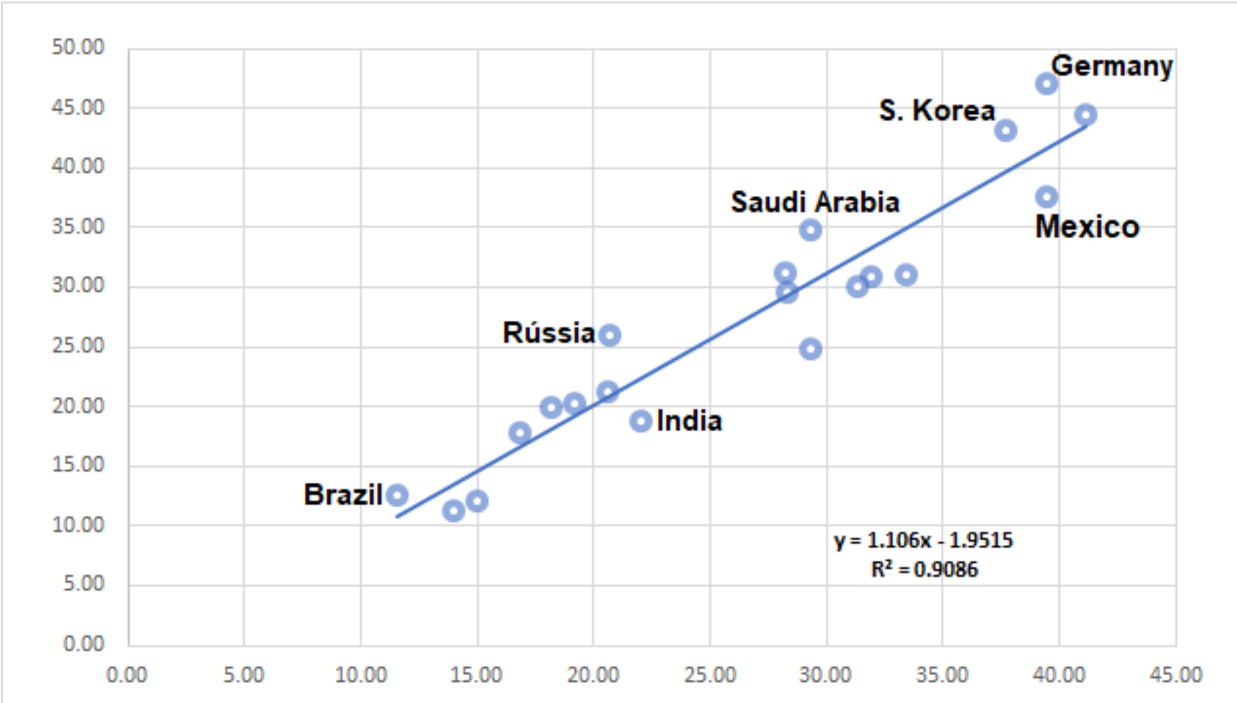
TOTAL TRADE: BRAZIL V. CUBA (% OF GDP)



Source: World Bank, 2017

The Brazilian import substitution policy was temporarily effective in terms of achieving the country's industrialization. Indeed, Brazil has industrialized considerably since the 1930s, peaking in the 1980s. However, such "effectiveness" came at an enormous cost to the Brazilian citizens' pockets, both as taxpayers and as consumers. While Brazil is the country with the lowest rate of imports, international data shows there is a strong correlation between import rates and export rates, highlighting that the strategy of "substituting" imports is not a net positive as it hinders technology transfer, human capital accumulation, and prevents economic integration to the global production chains.

CORRELATION BETWEEN IMPORTS AND EXPORTS OF THE G20 ECONOMIES



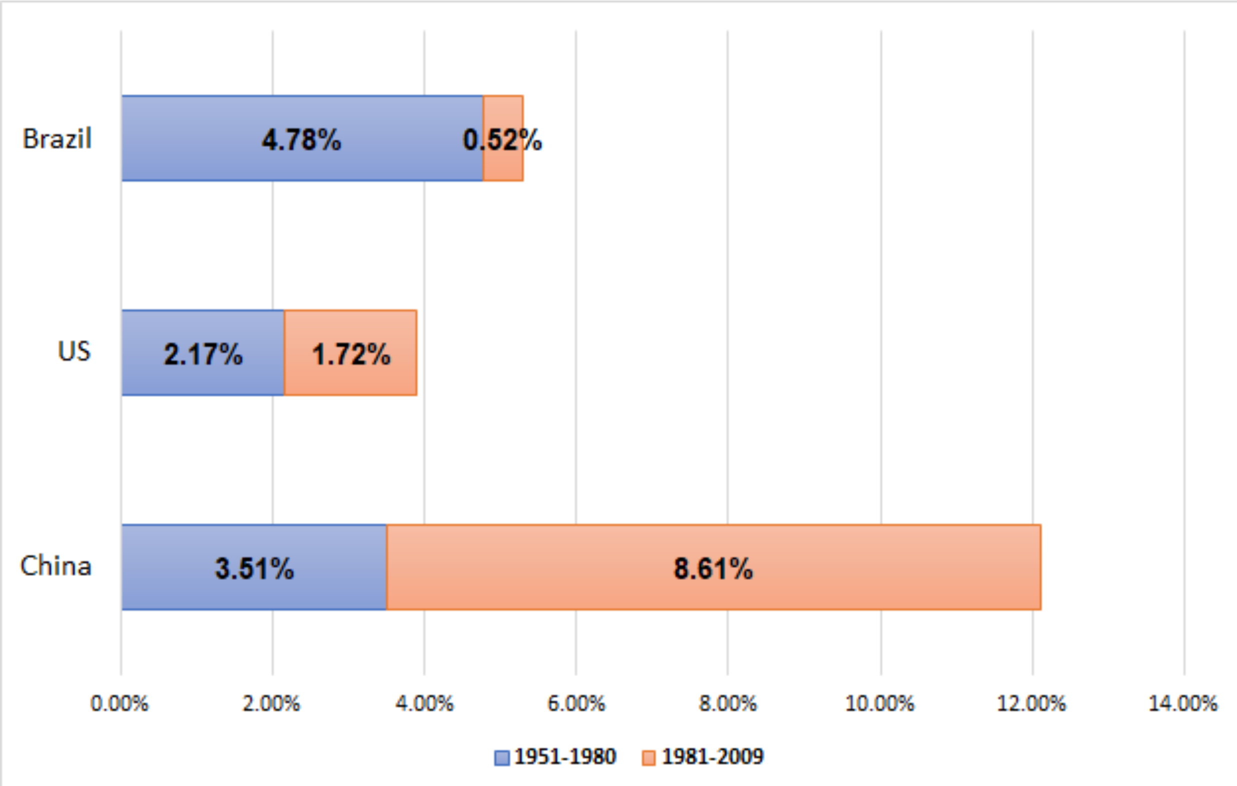
Source: World Bank, 2017

During the Dilma Rousseff administration, such mistaken policy was pushed further, with measures such as raising taxes on more than 100 imported products at once, as well as raising quotas for mandatory domestic inputs in multiple industrial sectors.

There is a strong correlation between increased imports and higher investments in Brazil. The increase in imports may explain up to 64% of the variation in investments (Sarquis, 2011). Initially, it might seem counterintuitive, but as demonstrated since Smith and Ricardo, imports facilitate specialization and division of labor and make countries strengthen their comparative advantages. In addition, they facilitate technology transfer and human capital accumulation while helping countries integrate into global value chains. Finally, when a country intensifies its protectionist policy, it can foster retaliation by its economic partners, making any kind of gain only temporary, and preventing the permanent gains from free trade.

Data shows the Brazilian trade policy has been repeatedly incompetent for the country to catch-up with developed economies, that is, to reach similar levels of income per capita, especially if compared to other developing economies such as China. Although the Brazilian economy grew faster than the US from 1951 to 2009, significant progress was made until the 1980s, since then things have changed and the country has experienced slower per capita income growth than the US. On the other hand, China, which was already growing faster than the United States, accelerated its economic growth in the period.

AVERAGE ANNUAL ECONOMIC GROWTH RATE FROM 1951 TO 2009 (BRAZIL, US, AND CHINA)



Source: Penn World Table in Sarquis (2011)

We can draw some lessons for Brazil from international experience. From the postwar era onward, we see that there was an intensification of world trade relations, especially in the United States and Europe. This has contributed to economic growth and the maintenance of peace worldwide. Developed economies demonstrate that in order to export more, one must import more. Therefore, Brazil must open its economy to imports if it wants to export more.

More recently, Asia has been the most economically dynamic region in the world and has experienced rapid and seemingly sustainable growth (despite some problems). In addition to China emerging as the world's second-largest economy and Japan as the third, countries such as South Korea and Singapore, as well as Hong Kong, have made a rapid transition and are now considered high or upper-middle-income countries. The Asian "miracle" came largely from focusing on global markets. In the present day, the region produces a significant part of the industrial goods consumed worldwide. This contrasts with the Brazilian policy of import substitution and supplying only for the domestic market.

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