Brazil's Rise and the Role of Big Business

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Abstract: *The heart of Brazil's recent rise in international relations lies in its growing influence in the global economic arena. This article evaluates one aspect of economic activity – the emergence of Brazilian transnational corporations. The article argues that an important legacy of decades of state intervention in the market fostered the successful internationalisation of big business in Brazil, impacting on Brazil's international profile. However, this legacy also hampered its systemic competitiveness as evidenced by various international competitiveness rankings. The article concludes with some remarks on the long-run sustainability of Brazil's current economic performance.*

Introduction

In 2003, a Goldman Sachs study included Brazil as one of the top four emerging markets in the so-called BRICs, leading to scepticism about whether it deserved this position. Five years later, few doubters remain. By 2008, Brazil had not only gained investment grade status from the major international credit rating agencies, it also had greater clout in a number of issue areas of global importance, including a prominent role in trade, international finance, environment and energy debates.

Today, few would disagree with the claim that Brazil's star is on the ascendant. Winning the bid to host the Olympics in 2016 was generally interpreted as a sign of Brazil's rising importance both in Brazil and the world. World leaders have acknowledged Brazil's growing influence on the world stage. President Obama famously greeted his Brazilian counterpart with "you're my man" at the G20 Summit in London in 2009. Brazil also has received more coverage and attention in the international media and amongst prominent think tanks. In 2009, the Financial Times, The Economist and the Brookings Institution dedicated special sections, reports and books respectively to understanding Brazil's growing global economic weight. President Luiz Inácio (Lula) da Silva's high profile and Brazil's good economic performance in the midst of global financial crisis are the dominant themes.

This article examines one key, but little studied reason for Brazil's recent rise to international prominence – the role of its big businesses. More specifically, it evaluates to what extent economic conditions and business actions have contributed to the enhanced image and influence of the country. It argues that an important legacy of decades of state intervention in the market and a continued willingness to do so when necessary (albeit in a generally stable and liberalised economic context) fostered the success of big business in Brazil, contributing directly to the growth and internationalisation of the Brazilian economy.

The article is divided into five sections: (i) historical context and economic background; (ii) current economic context within which business operates; (iii) contribution of Brazilian big business to the economy's enhanced performance; (iv) reasons for their successful internationalisation; and (v) prospects for Brazil consolidating its growing global influence.

Historical Context

Brazil's economic growth and industrialisation in the second half of the twentieth century took place under the aegis of an interventionist state and a policy of import substitution industrialisation (ISI), guided by the principles of the structuralist school as best embodied in the early work of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC). From the point of view of Brazilian economic policymakers, the Cold War was actually perceived of as a unipolar rather than bipolar system, since joining the Soviet camp was simply never an option. Notwithstanding heavy state intervention in the economy and its nationalist and third-world rhetoric in the 1960s and 1970s, Brazil was always resolutely capitalist. It never adhered to the Non-Aligned Movement and only rarely took positions against the United States on security related matters. It was less clear to what extent Brazil's inwardly oriented developmentalist project to create a diversified and modern economy relied on the 'embedded liberalism' of the Cold War period and the benign neglect of the US where economic policy was concerned.

By the 1980s, ISI had run its course and the debt crisis ended the high spending ways of Brazil's national developmentalism.[1] The economic downturn also ruptured one of the main features of the previous economic model, that is, the *tripé* or tripod of actors (state-owned, foreign-owned and national family-owned enterprises) supporting Brazil's economic growth and industrialisation.[2] The *tripé* model's collapse dissolved the mutual development-enhancing interaction of previous decades.

Although Brazil was a laggard in terms of adopting the Washington Consensus policy prescription, it reluctantly introduced some market reforms in the early 1990s.[3] Unilateral trade liberalisation and other reforms, such as privatisation and deregulation, forced a massive restructuring of industry. At the same time, business had to grapple with out of control inflation until 1994, when the launch of the Real Plan finally brought price stabilisation. This plan also became the subsequent foundation for strictly managed and prudent macroeconomic policy. After a brief sharp economic crisis in 1998-99, adjustments were made to the Real Plan, and in the following decade Brazilian macroeconomic policy remained focused on three pillars: inflation targeting, primary surplus and floating currency. Although the heavy emphasis on generating a primary surplus reduced state support and subsidies to business, overall the three pillars and policy continuity directly benefited business and shaped corporate strategies in these years.

However, it is important to understand that even at the height of market-oriented reforms, the Brazilian government was prepared to engage in industrial policy.4 The government took a pragmatic approach to microeconomic or industrial policy, with pro-interventionist and state developmentalist elements always represented in policymaking circles, but it also continued to acknowledge that market forces should be given a primary role in boosting economic performance.5 It is within this context that Brazilian business consolidated the gains of restructuring and in some cases utilised these gains as a springboard for adopting internationalisation strategies as discussed below. The mixed economic policy context and nuanced approach to market oriented reforms created an ideal environment for business to look to emerging opportunities in global markets.

Current Policy Context

Two favourable factors stood out in the current policy context: stable macroeconomic fundamentals and changes in the microeconomic policy framework, especially in the area of technology and innovation policy. However, these sometimes were more than counterbalanced by two crucial factors standing in the way of better results. These were the difficulty of inculcating a shift in the mindset of business towards expectations of state intervention and the on-going practical constraints on Brazil's economic expansion collectively referred to as *Custo Brasil* or Brazil Cost. While the former set of favourable factors fostered Brazilian TNC successes, the latter set were a drag on the competitiveness of businesses.

The stable macroeconomic context combined with a vigilant state on all economic matters directly contributed to Brazil's recent rise to prominence in the world economy. By the beginning of the twenty-first century, Brazilian economic policy could be labelled 'neodevelopmentalist'.6 Brazil had learnt the benefits of stable monetary policy and solid fiscal accounts, but policymakers also continued to emphasise the idea that the effective operation of market forces demanded complementary state actions.7 Many businesses saw the benefits of this approach, what Kurtz & Brooks call 'embedded neo-liberalism' and Leiva identifies as the distinct feature of 'neo-structuralism'.8 It was precisely the neo-structural argument to balance the benefits of state intervention with macroeconomic prudence, which shaped corporate strategies. In fact, it is difficult to understand the successes of Brazilian TNCs without understanding the nature of the state's implicit supportive role in building their global competitiveness.

Given the limited scope for government action in the macroeconomic area, in November 2003 President Lula announced the Policy for Industry, Technology and Foreign Trade (PITCE), which focused on microeconomic policy to enhance business operating conditions and boost competitiveness. This included changes in corporate governance legislation, better access to credit and financing, and some limited tax reform. However, it was technology and innovation policy that was put at the centre of the new policy and that was identified as one of the most significant areas for government action. Accordingly, in his first term in office (2003-2006), President

Lula sponsored legislation and created new institutions to deal with this policy area. For example, Laws 10,973/2004 and 11,196/2005 covered provisions for supporting technological innovation. He also set up the National Industrial Development Council (CNDI) and the Brazilian Industrial Development Agency (ABDI) to provide institutional oversight of policy formulation and implementation in this area. These policies were later extended and deepened in his second term (2007-2010) in the Production Development Plan (PDP) announced in May 2008.

However, it was not so simple to instigate a shift in the mindset of businesses. Not only were they reluctant to give up the privileges of past corporatist protection and special access to the state, but they also found it singularly difficult to move from conceiving of the economy as a system of production to thinking of it as a system of innovation.[9] Although the scope of this article prevents a full discussion of technology policy and the challenge of building a national system of innovation, it is crucial to understand its key importance to the growing influence of Brazil in the global economy and the rise of Brazilian TNCs.[10]

The other key constraint on improving Brazil's relative performance in global markets relates to overcoming a series of issues affecting its systemic competitiveness. Some aspects of Custo Brasil, such as the onerous tax system and high tax burden, poor and expensive transport infrastructure, regulatory uncertainties, inflexible labour code, etc. seriously hampered the competitiveness of Brazilian firms and arguably delayed their internationalisation, when compared to their Asian counterparts. Businesses often reminded the government that it was remarkable that Brazilian exports still managed to be competitive in world markets.

It is also worth considering how Brazil compares with other economies as analysed in global surveys such as the World Bank's *Doing Business Report* and the World Economic Forum's *Competitiveness Report*. The latest edition of the World Bank study ranked Brazil 129th overall out of a total of 183 countries. This is hardly an encouraging or image enhancing position. Table 1 indicates a more detailed breakdown of the analysis for Brazil.[11]

Examining the details in each of the sub-categories gives one a better picture of the systemic obstacles to developing a competitive business in Brazil. For example, one of the worst ranked categories relates to paying taxes: for a medium sized company, it takes 2,600 hours each year to prepare, file and pay taxes in Brazil, in contrast to an average 194 hours/year in the OECD and an average 385 hours/year in Latin America and Caribbean (LAC). The total tax rate as a percentage of profit in Brazil is 69.2, while it is on average 44.5 in the OECD and 48.3 in LAC (note that LAC averages are considerably raised by Brazil).

The latest *World Competitiveness Report*, published in 2009, ranked Brazil in the upper mid-range of the surveyed economies at 56th out of a total of 134. Here again, Brazil's performance was less than stellar on a number of fronts. More interestingly, the private sector often came out looking much better than the state, and it probably compensated for the inefficiencies of the latter. Table 2 provides some more details.

Thus, Brazil presented a mixed policy context in terms of economic issues, although the overarching context of democracy and fortunate leadership choices over the past sixteen years not only raised Brazil's international profile, but also helped establish opportunities for Brazilian big business to internationalise. The next section examines some of the contributions that Brazilian TNCs have made to enhancing Brazil's image abroad, and the following section considers some of the reasons for their success.

Contribution of Big Business

Brazil's largest corporations experienced both quantitative and qualitative changes in the past decade, but especially from 2004 onwards – perhaps coincidentally also the tenth anniversary of the Real Plan. Whereas in 2004 there were only three Brazilian firms listed in the Fortune 500, there were six in 2009. However, unlike the rest of Latin America, where most big business was characterised by diversified family-owned groups, Brazil's largest firms additionally included institutionally-owned as well as specialised producers.14 Another relevant feature of these firms was that many of them began as state-owned enterprises under ISI, but were later privatised in the 1990s as part of the market reform agenda. Also, noteworthy was the heavily domestic market oriented strategies of even the biggest firms. Thus, there were no Brazilian firms in the world's top 100 non-financial TNCs *ranked by foreign assets*, and only three Brazilian firms in a similar list for developing countries.15 Finally, an important characteristic of Brazil's largest domestic-owned firms was their concentration in natural resource based sectors and in services, especially finance and construction. This was partly because of the legacy of the *tripé* model, which encouraged foreign TNCs to invest in many manufacturing sectors in Brazil. UNCTAD reports that there were 4172 foreign affiliates in Brazil in 2008. Thus, manufacturing, especially consumer durables, was mainly in the hands of large foreign-owned firms, leading to a rather different profile compared to big business in East Asia.

Despite this rather modest overall picture, big business was key to raising the international profile of Brazil. Here, the internationalisation process usually began with a growing foreign trade component in the firm's output, revenues and profits. In some cases, this led to listings in foreign stock exchanges, which was also seen as a demonstration of good corporate governance, and finally to outward investment flows. Thus, internationalisation of Brazilian big business was best analysed in terms of firms' contributions to international trade, attracting foreign direct investment (FDI) as well as portfolio investment, and finally in outward investment flows, i.e. Brazilian direct investment abroad (BDI).

Brazil's trade grew every year from 2002 to 2008. In 2008, it achieved record exports of US $197.9 billion, a surplus of US $24.8 billion, and a 1.1% share in total world trade. Brazil exported a diversified range of goods and services to a geographically diversified set of trade partners.[16] While foreign TNCs in Brazil contributed to exports, mainly transport equipment, domestic firms also played a key role. This ranged from firms engaged in the commodity trade – meat, orange juice, sugar, soybeans, coffee, iron ore, and a variety of other metals and minerals – to manufactured and semi-processed goods – aircraft, buses, footwear, machines & equipment, steel, etc. Some of the largest exporters eventually also extended their internationalisation strategies to acquiring assets abroad as discussed below.

According to the *World Investment Prospects Survey 2009-2011*, Brazil was ranked the fourth most attractive destination country for FDI, after China, the US and India.[17] Some of the highest scoring sub-categories in the survey for Brazil were size and growth of local market, access to international and regional markets, presence of suppliers and partners, cheap labour, and a stable and business-friendly environment. Thus, market-seeking FDI remained the main reason for investing in Brazil in the twenty-first century, much the same as in the mid-twentieth century in the early days of the ISI process. Although inward FDI fell year- on-year by 49.5% to US $23 billion in 2009, this was not surprising in the global context nor given that in 2008 Brazil registered a record US $45 billion inflow.

Brazil's main stock market, BOVESPA, has boomed since 2004, with the exception of the months immediately following the onset of the global financial crisis in September 2008. It launched 121 initial public offerings between 2004 and 2009. Accumulated gains in 2009 were over 84% in nominal local currency terms. Portfolio inflows from abroad were also consistently high for most of this period, including a record US $47.1 billion in 2009.[18] While the article does not intend to discuss this issue, financial analysts repeatedly comment on how the healthy domestic capital market was a contributing factor to the expansion of many Brazilian firms. Also relevant was the listing of Brazilian companies on foreign stock exchanges, usually New York. In March 2010, there were 33 Brazilian firms listed on the New York Stock Exchange (NYSE). This compared with Mexico (20), China (52), India (12), South Korea (8) as per the NYSE website. A significant aspect of NYSE listings was the recognition this earned firms with respect to their corporate governance and accounting practices.[19]

However, the most interesting trend in terms of the internationalisation of big business and the growing influence of Brazil in the global economy was the emergence of Brazilian TNCs. In 2005, Brazil had some 165 TNCs, and this number grew to 226 by 2008. While there were thirty four greenfield projects undertaken in 2005, these had risen to 97 by 2008. These TNCs also participated in cross-border mergers and acquisitions (M&A) in both advanced and developing countries. In 2007, Brazilian firms spent a record US $1.37 billion on M&A abroad.[20] Outward FDI increased every year since 2002 to a record US$ 45 billion in 2007.[21]

In 2006, Brazil ranked sixth among developing countries in terms of outward FDI stock. In the same year, outward FDI flows were greater than inward FDI for the first time ever. High levels of FDI were maintained through to 2008, but 2009 saw Brazilian TNCs decide to make a tactical retreat in the context of the global financial crisis. The drop in outward flows was exclusively via a rise in inter-company loans rather than a reduction in assets abroad. The turnaround in the retraction and a return to trend was already evident in the first two months of 2010, where BDI was US $5.4 billion. A survey of TNCs indicated that 38.8% of firms intended to increase outward investment flows in 2010.22

Most of Brazil's largest TNCs operate in natural resource based sectors (mining, energy and agricultural commodities) or in services (mainly engineering and construction, with an incipient role for financial services). The big names included mining giant Vale (formerly CVRD with investments in 33 countries) ranked 12th among developing country based TNCs in terms of foreign assets; energy sector state-owned enterprise PETROBRAS ranked 14th; and the steel manufacturer Metalurgica Gerdau ranked 28th.23 There is only one outstanding example of manufacturing in a high technology sector in Brazil, the commercial aircraft manufacturer EMBRAER.24 Other big business names with an international presence include meat processors JBS and Sadia-Perdigão, drinks company AMBEV, pulp and paper firms Suzano and Aracruz, engineering and construction firms Odebrecht and Camargo Corrêa, airlines Gol and TAM, financial services and banks such as Itaú and Bradesco.25 The 20 largest Brazilian TNCs earn 25% of their revenues abroad, hold 28% of their assets abroad, and 27% of their employees abroad.26

The above analysis demonstrated the role and contributions of Brazilian TNCs to Brazil's overall international presence. Although in some areas they are acknowledged as global players, there are many more sectors where they play a much smaller role than could be expected. For example, notwithstanding the impressive absolute growth in exports, Brazil still only had a small share in overall world trade. Similarly, despite the success of certain Brazilian TNCs, in absolute terms they did not rank amongst the biggest in the world. More troublingly, from a neo-developmentalist perspective, Brazil's largest firms do not operate in high-technology sectors, with the exceptions of EMBRAER and certain aspects of PETROBRAS' business. More worryingly, the share of manufactures in its exports has been gradually shrinking from over 69% in 1996 to 55% in 2005 and most recently to under 50% in 2009. So, should Brazilian big business be seen as a success in terms of their role and influence in global markets? Why were some Brazilian TNCs successful? What was the role of the state in their internationalisation?

Reasons for Success of Brazilian TNCs

Although it is tempting to credit business' strategic decisions for success, it is difficult to get away from the conclusion that Brazilian big business thrived precisely due to the critical role of the state in their growth and evolution. This holds for SOEs, ex-SOEs as well as many of the largest family-owned business groups. The state's role was best analysed both in terms of past policies that shaped 'dynamic legacies' as well as the impact of current policy priorities on the business environment.27 In terms of the past, few of the biggest global players in Brazil today would have been in a position to expand their operations without prior state support under ISI.28 In terms of the current situation, the state not only shaped the context within which these firms operated, but also specifically utilised macroeconomic and microeconomic polices to guide business strategies and choices in terms of investment, employment and innovation. These implicitly also determined the opportunities for internationalisation. In some cases, the Brazilian TNCs international advantage was reinforced by special technological advantages they might have acquired in the course of doing business at home, often conditioned by the state's previous policies for technological development in the firm's area of specialisation. PETROBRAS and EMBRAER were excellent examples of this phenomenon.

Even after privatisation and economic liberalisation, the state still played a significant role in shaping corporate strategies.29 For example, export financing, credit and loan policies of the Brazilian National Development Bank (BNDES) directly affected internationalisation strategies. More general state policies related to company law, bankruptcy provisions, technology policy, growth of equity markets, higher education provision, etc. materially impacted the efficiency and competitiveness of Brazilian business. Thus, the domestic policy environment – past and present – was crucial in placing firms in a position to take advantage of global market opportunities.

Another explanation for successful internationalisation of Brazilian big business could be found in the boom in global commodity markets that specifically favoured Brazil's natural resource endowments. Here it was imperative to highlight the role China's growth and appetite for commodities played in raising Brazil to the status of global player. The commodity bonanza of the past decade contributed to higher export earnings as well as opportunities for well-placed Brazilian firms to expand their operations abroad. However, commodity exporters rarely achieved global brand recognition, since they competed more on price than quality and usually directly supplied a small number of clients abroad minimizing the need to spend on marketing and advertising. Thus, although their names were not recognised by the average final consumer, they were well known to their direct clients and to customs authorities and trade policy officials dealing with their sector.

To summarise, the two main reasons for success of Brazilian TNCs and rising profile in the world economy – role of domestic policy and demand in world markets – were mutually reinforcing. It remains to be seen whether changes in the global economic context translate into more presence and a better opportunities for Brazilian firms.

Prospects

So, although overall a positive reading of Brazil's increasingly prominent TNCs was the dominant theme in international capital markets and media coverage, it is important to note that much of their rise was associated with past state interventionism and on-going neo-developmentalist proclivities. This might raise some questions about whether this process can be replicated indefinitely, and about whether it makes sense for Brazil to expect growing influence as a global player. Should the commodity boom fade, where would Brazil's TNCs feature? Can Brazil be satisfied with its current export and FDI profile? Why was Brazil, one of the top ten largest economies in the world, unable to develop a more prominent position in dynamic sectors of the global economy? If the future lies in the hands of the knowledge economy, Brazil is going to have to do much more to maintain its place as a global player.

To conclude, it is still too early to say whether Brazil will consolidate its position as one of the countries included in the small group of agenda setting states in the global economy. Clearly, both state and business were engaged with the process of internationalisation. Democracy and the absence of any internal or external disputes provided a stable political and economic context for business to thrive. Brazil certainly was good at balancing its actions and enhancing its influence in the North-South as well as South-South arenas. It was successful in showing an increasingly internationally appreciated ability for inclusion and dialogue with the full ideological spectrum on security and economic matters. For example, President Lula has had positive interactions with Iran and Venezuela, even while maintaining good relations with the US, Israel and Europe. Finally, Brazil undoubtedly benefited from the generosity of nature – it was in an extremely comfortable position and feared no shortages with respect to food, energy, water and other resources in the coming century when compared to the other BRICs. So, although Brazil may be the least spectacular performer of the four BRIC economies at the start of the twenty-first century, it may go on to become the most stable and secure of them all.

Notes

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