Session 6

The Quest for Innovation: Geopolitical and Geoconomic Implications of the BRICs

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The idea of "BRICs" (group of nations comprising Brazil, Russia, India and China) as a valid category for the analysis of present and future international relations is a "concept-in-the-making".

The success of each of these countries in the political economy of the twenty-first century will come mostly from answers to 4 questions each of these rising stars are obliged to address:

– What is your vision for your country´s future?

– How do you pursue your goals in an interdependent and yet conflict-ridden world?

– How are you preparing for the digital economy of knowledge?

– What sacrifices are you willing to make?

Indeed, for BRICs to act as a group, allowing for greater internal and external policy cohesion, join forces and thus exert greater influence upon international relations, they depend on making progress in terms of:

– becoming more than just nations that share similar geographical, social and economic statistics –vast territory, large population, booming economy, great potential to play constructive or fragmentary roles in their geopolitical regions and in the global economy;

– building well-articulated views and actions in pursuit of their interests and in understanding how the world should work,

– establishing regular and formal structures that bring together business leaders, civil society and government authorities in formulating common agendas.

To that end, it is worth remembering what the BRICs are not (at least until now):

– BRICs are not an international organization.

– They are not either an economic block with free-trade arrangements.

– They are only taking their first steps towards a platform for building consensus on international agenda items such as human rights, environment, international peace and security, rules for international trade, joint action in the UN or the WTO, and so on.

BRICs must know what they want for their countries, their elites; what they want for the world and from the world. So one must ask whether the BRICS have:

– A power project?

– A prosperity project?

– A project for prestige?

The idea of BRICs therefore emerged as one pertaining to how the future is going to be built. These great nations have reached the status of economic powerhouses because for the past 3 decades they have been able to adapt successfully to the changing contours of the global economy. Namely, in a world where the generation of jobs is key to economic success, these countries have been able to pursue alternative strategies so that their economies were always busy in providing local content.

The future for the BRICs as growth engines however must not reside in efficiently adapting to the global economy, but rather in effectively shaping it. This will necessarily entail these countries evolving from being successful local content providers towards becoming dynamic hubs of knowledge and innovation.

The clash for competitiveness

Now, as global capitalism struggles to find a way out of the present existential crisis, a strong trend is showing its face in the world economy, a trend that goes beyond the BRICS. Against a backdrop of great uncertainty, countries are increasingly adopting industrial and trade policies based on a notion we can call "local-contentism". The practice is becoming the most recurrent tool in bulking up a nation's capacity to compete in world trade and attract investment, regardless of whether it is targeted at infant-industries, high-tech sectors or more mature, old-world manufactures. On a global scale, we are experiencing far more than just "currency wars". Exchange-rate tactics make for ancillary rather than decisive battles. The world has set the stage for the waging of "clashes for competitiveness".

Many confuse local-contentism with defensive trade measures erected against artificial exchange-rate stratagems that boost the attractiveness of a country's exports. There are clear differences however between local-contentism and old-school protectionism. While the latter is essentially about import quotas and tariff barriers set up to protect what is "national", the former idolizes foreign direct investment and makes extensive use of government procurements as bait. After all, by its very definition, local-contentism is all about being "local". Successful local-content initiatives enacted by the BRICs have parted ways with traditional forms of xenophobic protectionism that plagued economic policies during much of the twentieth century. One no longer speaks of the nationalization of industrial assets, as if wealth resided in possessing physical facilities, not in people's talents or knowledge-intensive processes.

But the recent move towards local-contentism is also visible on radar screens turned to the US and Europe. This year's presidential campaigns in America and France are not centered on free markets or enhanced regional economic integration. They focus instead on the job creation side of local-contentism.

Comparing China and Brazil

China's hyper-competitiveness for example is the supreme case of intricate, sophisticated policies of local-contentism, which since 1978 have included:

– PPPs (public-private partnerships) as a springboard for exports and attracting foreign direct investment;

– the (once) low cost of China's domestic factors of production;– privileged access to the world's most important buying markets;

– a vigorous business diplomacy, which reportedly results in two separate Chinese trade and investment missions visiting to the US and Europe every day.

The hyper-competitiveness of the Chinese, driving its annual GDP in terms of purchase power parity to more US$ 10 trillion, has produced a virtual "eclipse" in the world economy. Apart from the traditional global economic centers in the US and Europe, China has now become a "new center".

And this is indeed remarkable. Imagine boarding a time machine back to 1971 and arriving at a conference bringing together Nobel Laureates, as well as some of the world´s most respected strategists and futurologists. Suppose the goal of this conference goal was to prophesize on the future of China and Brazil.

To guide the projections, a series of questions was asked. If one was to take a bet that, in 2011, which of these two countries would:

– overtake by 2020 the nominal GDP of the U.S. and therefore become the world's largest economy?
– hold more than 60% of its GDP associated to foreign trade?
– become the world´s top destination for foreign direct investment (FDI)?

Which one would it be, China or Brazil?

All would bet their chips in Brazil. In the early 70s, the South American giant was in the midst of the "Brazilian Miracle", with its economy growing at over 10% per year. Then as now, there was great enthusiasm around the world for Brazil.

China in the 70s drew international attention not for its production of goods and services, but for its production of problems. What happened during these past four decades to propel China to such a prominence? Even now with Brazil in full fashion around the world and the respect one must carry for the potential of other emerging markets, the fact is that, in 2012, Brazil, India and Russia together are the economically equivalent to one China.

The big difference is that Brazil faced the last two decades with a "lantern on the stern" (and sometimes the lantern was off). China projected a "lantern aimed at the future". China drew a plan. The cat, no matter its color, would hunt mice. It chose a model. It stuck to it. Brazil didn´t. China decided to radiate power and prestige from a solid economic base. It devised a national project based on foreign trade and the attraction of FDI. It promoted – and still promotes – generational sacrifices on behalf of savings and investment, both at around 50% of GDP.

The Brazilian macroeconomic disorder of the 80s and part of the 90s swept the notion of "long term" away from Brazil´s economic lexicon. Brazilians suffered as a consequence. The suffering people underwent though cannot be seen as a "sacrifice" in the name of a national project… for the simple reason that there was no national project.

The way China has thus combined over the years Public-Private Partnerships, labor law, cheap workforce, a favorable approach to foreign capital and a light tax burden makes the country the largest manufacturing park in the world.

Brazil has not managed to implement throughout these four past decades a project of power or prosperity. Today, it confuses the concept of a national project with the recovery of lost time. Physical infrastructure, ports, airports and roads – it is the past catching up with the present. As a matter of fact, contemporary Brazil is seeing the quiet renaissance of "Import Substitution Industrialization 2.0" or ISI 2.0.

From the early 1950s, Brazil used import substitution to change the DNA of a country historically attached to agriculture and mining. Its most spectacular periods of growth in the 20th Century –President Juscelino Kubitschek's "50 Years in 5" (1956-61) and the "Brazilian Miracle" (1967-73)– were largely the result of ISI. It produced annual growth rates in excess of 10 per cent and indeed converted Brazil into a large industrial economy targeted at a vibrant domestic market. However, inarticulate exchange-rate policies, a lack of vertical industrial integration and unfavorable international junctures have made inflation and foreign debt the "twin sisters" of ISI.

ISI 2.0 can be easily identified in the way state-owned enterprises, official banks, municipalities, states and the Federal Government interpret and implement Brazil's interests in the global economy. Today, ISI 2.0 is the parameter of how government in Brazil protects

domestic companies from foreign competition, fosters local content and goes about procurements.

Present day ISI 2.0 has two faces. It continues to apply high import taxes and other barriers to protect national groups and foster Brazil's chosen industrial priorities (semiconductors, software, electronics, automobiles and others). As the country's currency is clearly overvalued, its trade deficit in manufactured goods would be even larger if it were not for tariff shields – which contribute to the outrageous prices paid by Brazilian consumers for many foreign goods. Much like its 1950s prototype, ISI 2.0 is clearly "nationalistic". It nonetheless updates the concept of "economic nationalism". Rather than merely sheltering Brazilian entrepreneurs, ISI 2.0 calls for the "Brazilianisation" of companies wishing to harness the potential of Brazil's domestic market. An entire set of incentives is put to the service of those who decide to create jobs in Brazil. Its most powerful tool is the robust policy of government procurement, which has found expression in the Lula-Dilma administrations (of Luiz Inácio Lula da Silva, president from 2003 to 2010, and Dilma Rousseff, president since January 2011).

Brazil is operating under what we could call "the pre-salt hedge". According to this notion, multiplier effects of new oil discoveries for those who decide to invest in Brazil will be so huge during the next 30 years that they "anchor" the decision to set up long-term operations in the country. That is why 2011, in spite of the global crisis, sees Brazil receiving $65bn in foreign direct investment, 5 per cent of the world's total.

Is all this good news for Brazil? No. It may become an underperformer among the Brics and other EMs as it continues to sweep urgently needed labor, tax and political reforms under the carpet. And Brazil's ISI 2.0 is inherently vulnerable. It relies on heavy, non-stop flows of FDI pouring in over many years. For all this to work smoothly, ISI 2.0 must generate shorter learning cycles to boost rapid and voluminous productivity gains – conspicuously absent in Brazil.

The future for Brazil lies in making its companies tech-intensive in various industries. There is nothing more strategic for Brazil than transforming its creative people into a society of entrepreneurship and innovation. Brazil´s comparative advantages of today (bio-energy, mining, oil, pre-salt) have to be put to the service of building the competitive advantages of tomorrow (expanded R & D, patents, new products, companies and universities inextricably linked).
The timid expansion of Brazil's GDP in the past 12 months at under 1 per cent deals a hard blow to the notion that its policy makers had devised an economic model uniting high growth with social inclusion. This sweet dream is over. It is wrong to assume that the set of policies Brazil has put in place in the past few years to boost its economy and upgrade its social data are pillars of a new development model.

What does exist in Brazil, stretching back beyond current President Dilma Roussef and her predecessor President Lula, is a cyclical attempt to promote growth that constitutes a "pattern". It is based on the appetite of Brazil's domestic market for high levels of consumption. The pattern has indeed been accompanied in the past 10 years by income distribution mechanisms that lifted the lives of millions. They are however targeted at poverty alleviation –not increasing productivity– and therefore are not engines for sustained development over time. This pattern made Brazil fall in love with the present. It is time to end this affair. Brazil has to go back to being the "country of the future".

Economic "models" and "patterns" are quite different things. The former are strategic and dynamic in nature. They include a plan, a well-structured vision of the future. The latter are

tactical and recurrent –they react to changes in the global economy. Models are about development. Patterns are about growth.

In policy-making quarters, many seem to feel it is possible for Brazil to keep expanding its economy at impressive rates by fostering domestic consumption. Brazil has already applied such mechanisms in the past. Although the economy does respond positively to one or another stimulus, there are many constraints for such a growth pattern to become a development model. Brazil has low levels of savings and investment, outdated labor and tax legislation and infrastructure bottlenecks. It lags behind its competitors in education, science and technology.

Brazil has to choose a development model and adopt it wholeheartedly. Brazilian authorities cannot fool themselves. It is useless to quixotically gear up against 'currency wars', build walls to restrain the 'financial tsunami' and denounce the 'monetary protectionism' practiced by advanced economies. If truth be told, a more stable scenario in Europe and a larger availability of capital worldwide are essential to Brazil's ambitions of growth. Brazil only saves about 16 per cent of its GDP and thus depends heavily on financial flows as well as robust foreign direct investment.

Interest payments, pensions, public sector wages, government inefficiencies and Kafkaesque business regulations keep Brazil from pursuing a development road paved by science, technology, innovation, start-up capital and entrepreneurial spirit. The country has a hard time putting together a priority list and sacrificing for it. But Brazil presents clear potential for the old economy of commodities to build new competencies in tech-intensive sectors.

This would necessarily involve the many areas in which Brazil has comparative advantages, such as agribusiness, mining, deep-water oil and bio-fuels. These should be the bases for a new economic platform to generate surpluses and service the construction of new competitive advantages in nanotechnology, bioengineering, biotechnology, high value chemicals, new materials and robotics. These are the vehicles that could drive Brazil to the forefront of emerging markets.

The current reinterpretation of import substitution policies in Brazil is a good example of the difference between a development model and a growth pattern. Nearly all experiences in industrial development around the world have resorted to some sort of import substitution. This is almost a necessary stopover to local capacity building. Import substitution however cannot be seen as an ever-lasting golden rule. It is only to be applied at an infant-industry level so as to enable a particular sector of the economy to compete internationally.

Building a development model requires at least three ingredients. Political will, capital availability and a good diagnosis of what the world is today. Brazilian politicians have always been criticized for lacking the political will for change. But it would be unfair to think of someone like President Rousseff as deprived of the will to build a shortcut to development and thus propel Brazil towards a much higher socio-economic status. She is eager to make a difference. President Rousseff is increasingly aware of the importance of innovation and of how crucial it is to reposition Brazil competitively in the realm of the so-called "knowledge economy".

Nonetheless, contemporary Brazil continues to confuse the growth pattern brought about by specific incentives for consumption and industry protection with a model that allows for productivity gains and sustained economic development. Brazil should worry instead about the gap between its huge potential and its low capacity to compete globally. Over the past 25

years, Brazil's productivity grew at just 0.2 per cent a year, while the annual change in China was 4 per cent.

Brazil must raise domestic savings and investment as a percentage of GDP and direct more resources to education, science and technology –the indispensable tools to fight crises and promote sustained prosperity. Embarking on a serious effort to enact much-needed structural reforms will free Brazil from the current microeconomic straitjackets. They would be the best stimulus the Brazilian government could offer all those willing to help the country develop its potential to the fullest.

From local content providers to innovation hubs

Brazil, Russia and India therefore have major concerns of their own over how the rise of China contributes to the "deindustrialization" of their economies. Nevertheless, these countries have been able to partially offset their China-led deindustrialization by "reindustrializing" through their own version of local-contentism.

One of the reasons Brazil for example has been able to accumulate enough capital to foster local content is that China has overtaken the US and European Union as Brazil's top trading partner and one of the prime sources of FDI. China's appetite for agricultural and mineral commodities, where Brazil has competitive advantages, has automatically extended economic cooperation to other areas (logistics, infrastructure, aircraft and others).

Brazilian, Russian and Indian manufacturers, who worry deeply about a "flood" of Chinese goods into their markets, would doubtlessly appreciate their governments taking action in the form of quotas and other import restrictions. However, they are less critical of China's exchange rate policies and more vocal in denouncing their own outdated and non-competitive domestic labor and fiscal laws, shortage of domestic infrastructure and high cost of capital, which hurt these countries domestic and international competitiveness more than China' s cheap yuan. As a consequence, if, on the one hand, local-contentism is a pillar upon which China built the components for becoming a global growth engine, on the other it is also one of the concepts countries are now implementing to fight China's hyper-competitiveness. We may therefore see in the near future fewer "Made in the World" goods coming from "network-corporations" that in the heyday of globalization combined worldwide logistics, supply chains and talent pools to achieve productivity gains, and more of these processes taking place simultaneously in a single country. Even China, which based its prosperity on a "trading nation" strategy, will have to model its local-contentism not so much on the way it sells to the world, but rather on how China buys from the world. Major contracts by China's government, corporations and consumers as buyers will have to support activities carried out locally, generating local jobs and taxes.

Although local-contentism can benefit one nation or another for a number of years, the global economy will pay a heavy price for the loss of efficiency it entails. If instead of playing a part in a country's catching-up strategy local-contentism becomes an across-the-board philosophy for our times, we can only expect ever-growing economic imbalances and further international inequality.

If, alternatively, local content remains an essential part of BRICs' industrial policies only up to the point where their corporations are able to compete on a leveled playing field, then BRICs´ vocation as global growth engines will definitely be confirmed. If the BRICs are indeed able to translate their local content policies into springboards for knowledge and innovation, they will certainly become the world´s most dynamic, prosperous and influential group of nations.