SERVICES AND MANUFACTURING COMPETITIVENESS IN BRAZIL

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Services are becoming increasingly relevant in economic policy agendas due to their growing importance in explaining the performance of enterprises, the type and form of participation of countries in global value chains, and prospects for sustained growth.

New production technologies and production organization, as well as changes in consumption patterns and in the nature of manufactured goods, are bringing industry and services closer together. In fact, empirical evidence suggests that goods and services are merging together through an increasingly synergetic and symbiotic relationship to give rise to a third product that is neither a traditional industrial good nor a conventional service. This complementariness between industry and services requires both activities to be competitive for them to benefit from each other.

In this study, we analyze services from the perspective of their functionality. For this purpose, we classified services into two different yet complementary families. The first family refers to functions that affect production costs, including logistics and transportation, general infrastructure services, storage, repairs and maintenance services, production outsourcing services in general, IT in general, credit and financial services, travel, accommodation, food products, distribution, among others. The second family refers to functions that contribute to adding value, differentiating and customizing products and, therefore, raising their market price and increasing labor productivity and return on capital. It includes R&D, design, engineering and architecture projects, consulting services, software, specialized technical services, high-end IT services, branding, marketing, trading, among others.
In principle, the longer the supply chain of a product, the greater the importance of cost services for its competitiveness. Cost services are particularly relevant for commoditized goods such as corn and soybeans crops, iron ore, oil, economy cars, clothes, and textiles. On the other hand, the more sophisticated and differentiated a product is, the greater the importance of services that add value to it.

The concentration of value-added services in rich countries is a feature of the new global economic landscape. It is no coincidence that they dominate global value chains. Less noble activities like production and assembly, in turn, are being outsourced to companies in developing countries that must compete to provide the best cost services in order to attract foreign investment and take part in global value chains.

The growing importance of value-added services in wealth creation is a factor driving greater activism on the part of rich countries in support of the global liberalization of services, particularly value-added ones, and more stringent intellectual property protection rules. This has become a key issue in negotiations around multilateral, regional and bilateral trade and investment agreements.

Considering the implications of the new global economic landscape, where the outlook for economic growth is increasingly based on services, we can reasonably expect to see an increase in per capita income inequalities across nations in coming years, even though developing countries are participating more – not less – in the global industry and economy through global value chains.

How is the relationship between manufacturing and services in Brazil? Have services contributed to increasing industrial competitiveness? The purpose of this study is to answer these questions from an international comparative perspective. The following key databases (from Brazil and abroad) were used to address these questions: Industrial Survey, Annual Service Survey, National Accounts, and National Household Sample Survey, all derived from IBGE; Annual Social Information Report, prepared by the Ministry of Labor; OECD World Input-Output Database; and Trade in Value Added – TiVA, OECD/WTO.

**Results**

Services account for a high and growing share of the value added in manufactured goods – in industrialized countries, this share is as high as 65%. Not surprisingly, evidence shows that the manufacturing industry’s ability to add value is related to the availability of the so-called business services in a country.
But the importance of services goes beyond their complementarity with industry. In fact, evidence shows that, first, an increasing share of foreign direct investment (FDI) in greenfield is going toward services – currently they account for 53% of the total; second, 67% of global FDI stock is allocated to services; third, companies must offer competitive services to take part in global value chains and receive FDI; fourth, services are now the main source of employment generation in the world; and, fifth, services are linked to export prices.

As shown in Figure 1, the share of the service sector in GDP is disproportionately high in Brazil, reaching levels seen in advanced economies. The share of services is high not only in GDP, but also in employment – 73% of the workforce is engaged in services and 82 in 100 new formal jobs are in the service sector. In other words, Brazil can already be characterized as a service economy, and anything that happens in this sector will affect the economy as a whole and, in particular, the sectors most dependent on services, such as industry.

**Figure 1. Per capita income and share of services in GDP- 2011**

We found the following evidence on Brazil:

*Industry and services go hand in hand* – Following the pattern of industrialized countries, industry and services have developed a close relationship in Brazil. The ratio of intermediate consumption of services to value added has reached levels only seen in industrialized economies: in 2011, this ratio stood at 64.5%, as shown in Figure 2.
But services have contributed little to enhancing industrial competitiveness. We found no evidence that services contribute toward increasing competitiveness in industry. Instead, the evidence shows that the prices of several industrial services are high even by international standards and that quality falls short of user expectations. From the high costs of export containers and electricity prices to transportation, financial services, maintenance services, and telephony and internet, services in general are an obstacle to business in Brazil. The low competitiveness of services can be partly explained by the sector’s modest labor productivity, which is at a very low level and has grown little. A high taxation, low competition and low investment are also major reasons behind the limited competitiveness of services in Brazil.

The high share of services in industrial value added was led mainly by changes in relative prices. Our evidence suggests that the high share of services in manufacturing is at least partly due to rising relative prices of services consumed by industry and to a decline in industrial value added. This evidence is relevant because it indicates that improving the service sector is key for Brazilian industry to recover its competitiveness and get back on track.

There is no common pattern in the relationship between services and industry on a disaggregated level. While manufacturing as a whole is consuming more services, a more disaggregated analysis reveals high heterogeneity, as shown in Figure 3.
Financial services and industrial and maintenance services provided by third parties account for most industrial spending on services – We found evidence of changes over time in the profile of services consumed by industry, as shown in Figure 4, which could be explained by changes in production organization technologies, production technologies, and consumption patterns. Despite changes over time, however, the most consumed services by industry at large are still financial expenses, industrial and maintenance services provided by third parties, and freight services – together they account for over 60% of the total. Yet, royalties and technical assistance are the services with the fastest-growing shares in total spending.
The service consumption profile is related to the industrial technology profile – Industries that are more technology-intensive and concentrated consume proportionately more sophisticated services such as royalties, technical assistance, and marketing, while those that are more commoditized consume proportionately more financial services, transportation, and services provided by third parties.

Brazil is consuming various imported services – Brazil is one of the largest importers of services. We have identified, however, that imported services are mainly for final consumption in the form of travel and for meeting the domestic market demand,
particular equipment rental and leasing, technical and professional services, and royalties and license fees. Imported services have contributed modestly to exports, as foreign sales are primarily based on commodities.

For Brazil to escape from the low-growth trap it has been stuck in since the 1980s and become a respected player in the global economy, it will have to place greater emphasis on value-added services and product differentiation. Nevertheless, we must recognize that, given the current stage of globalization, the discrepancies between Brazil and industrialized countries in terms of scientific and technological capacity, and the global trade rules being adopted today, the country will likely face additional challenges to make significant leaps toward increasing industrial value added.

A potentially promising approach is for Brazil to increase, not decrease, its participation in the global economy to benefit from the many opportunities that still exist to access technology, knowledge and investment. Brazil’s domestic market size and potential to industrialize comparative advantages will help it be successful. However, this strategy for greater integration will only work if it is part of a more ambitious development scheme focused on increasing industrial density.

It seems that integrating services into the core of industrial, technology, trade and investment policies is a key step to enhance industrial competitiveness. Deregulation in the service sector and lower taxes will also contribute toward attracting investment and strengthening the sector’s competitiveness.

The recent port, highway and airport concessions and the expansion of the electric power distribution system, along with Pronatec, REDESIM, and innovation support programs such as Inova Empresa (“Innovative Business”) and specific credit facilities granted by BNDES and FINEP will also help improve the quality of services in Brazil. Yet, the government will likely need to step up efforts for Brazil to close its industrial competitiveness gaps and place industry in a position to compete and participate in global value chains.