



## Foreign & Commonwealth Office

### **Brazil and the Rules-Based International Economic System: the Beautiful (but long) Game?**

1. In Brazil, football is the passion of the people. Some say it is a reflection of society. It may also be a good reflection of its economy. The aim of bringing Brazil closer to the global rules system feels like a football game – a long, tactical game and one of two halves. Without the same rules for all players, and an independent, fair and credible referee, there is less chance of winning – or at least of playing in a fair game.

### **Racing ahead...**

2. Brazil has had the best of the first half. For years, they have been the stars of the global system and not had to worry about all the rules. Why? They had some comparative advantages. First, vast stocks of natural resources – commodities were their Pele. Second, a young and growing population increased the labour supply. Third, early urbanisation brought together their diverse population increasing specialisation, skills-transfer and competition. Fourth, they had strong management – powerful and charismatic leaders and positive tactics after the reforms following the crisis of confidence in the 1990s. Better macro-management reduced the risks of volatility, boosted capacity to absorb external shocks; and built stronger defence against risks of high inflation and public debt that had historically caused so much unrest in the camp. Finally, they had overwhelming public support – nationalistic and proud. Força Brasil!

### **Running out of puff...?**

3. In the second half, however, there have been signs of fading. The natural resources have become less valuable, as lower overseas demand has reduced prices. Note – this may reduce the risks of Dutch disease (a team that despite vast natural resources has never won the World Cup). A lack of innovation and adaptation has held back productivity elsewhere. While the domestic economy remains resilient, this has been largely based on credit-fuelled internal consumption and high employment, which may not be sustainable. There is a reliance on playing inefficient state “champions” while the pool of more productive talent face barriers to selection. A lack of infrastructure investment means the stadia are crumbling. There has been growing pressure on the management. Supporters want change. Many are complaining about rising prices, the “Brazil cost” and corruption; and have been protesting in the streets. The slowdown has exposed the weaknesses, and makes it more important to consider global rules to help boost productivity.
4. There have also been two other shifts in the dynamics. First, the rules, referees and other leagues are growing stronger. Rule-making bodies, both regional (Pacific Alliance) and more global (OECD/IMF), are gaining more global traction as their credibility and support has grown. The PA is growing in strength, other FTAs such as TPP and TTIP are advancing and the OECD has attracted new members, while Brazil has chosen to play in slower leagues like Mercosul. Second, the supporters of the rules based system are getting stronger. Their openness to trade, investment and competition has increased their firepower and international esteem. Their

supporters are becoming more vocal, buoyed by success and calling for Brazil to play a more active role in the association. Brazil are strong, but could perform more strongly in the second half by engaging more actively in the global rules formation.

### Who will win?

5. There will be some turning points before the final whistle. Brazil's elections could bring a change of tactics, more pragmatism, but similar philosophy. Brazil has the chance to make some high impact substitutions. Early indications are they are planning to open up more (although only with the EU for now); they have already upped their game in terms of infrastructure investment and education, but will need to do much more to snatch victory. The World Cup offers a chance to shine. Winning would probably bring the management re-election, legitimacy (as it did for the military governments of Brazil and Argentina in the World Cup wins of 1970 and 1978) and, depending on the strength of the re-election result, belief that their model works. Even without victory, successful delivery of the tournament will bring respect, and buy them some time. Failing these two scenarios, there could be growing pressure for more fundamental change. Either way, the window to make important structural reforms may be wider after elections.

### 6. So what should the rule based team's tactics be?

- **It could be more ambitious and take some risks, but avoid scoring an own goal.** It could push a stronger G20/WTO/IMF agenda or be bolder in FTA deals, like EU-Mercosul, while credibility is on its side. But it must understand their motivations, tactics, strengths and weaknesses.
  - **Motivations:** Brazil wants a voice in setting rules and wants inclusion to ensure the interests of developing countries are represented. They will give and take, but will be frustrated if others do not give in return, particularly on issues like agriculture. Having Roberto Azevedo as head of the WTO could change the dynamics.
  - **Tactics:** they will continue to protect state champions, but are looking to open up (they have shown more willingness to do international business and auction state champions). They are also gradually implementing plans to develop infrastructure and education to stimulate growth, and recently enacted a new anti-bribery law based on that of the UK.
  - **Strengths:** they still have valuable natural resources, growing middle classes, a strong financial system and the injections of a World cup and Olympics in the next few years.
  - **Weaknesses:** they need much more investment in infrastructure, innovation and education; changes to labour laws; simpler tax systems; a quicker legal system, more efficient public procurement, and tighter credit markets to rein in consumption (though measures to do this have recently been implemented by the Central Bank).
- **The UK should try to understand what they see as our strengths and weaknesses and promote the expertise we have that they want.** The UK can offer City expertise on financial market deepening and financial inclusion; InfrastructureUK expertise on PPP project implementation and infrastructure services; science and innovation links that help diversification from commodity-production; experience of privatisation and regulation to introduce competition to inefficient markets (building on the good relationship between competition authorities). And we should work with like-minded actors in Brazil and global organisations to show that an even warmer embrace to global rules would be good for Brazil.

- **We should use football as a platform to enhance Brazil's engagement in the Rules Based System.** Brazil could be Pele again, playing a beautiful but a fair game. We recognise their strengths. Our willingness to engage in global rules and compete on a level playing field is also one of our strengths. We should exploit this as Brazil organises two of the greatest sporting events in the world, and all eyes will be on transparent and fair rules to win the day.