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CHALLENGES FACING BRAZILIAN ECONOMY IN THE EMERGING MARKET: FUTURE TRADE OPPORTUNITIES FOR MALAYSIA

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ABSTRACT

This paper presents the literature on international trade theory and practice with the intention of analyzing the trade opportunities between Malaysia and Brazil given the economic situation in Brazil and Malaysia. The literature relates to the discussions on the trade relationship and patterns between Brazil as one of the BRICs countries, and Malaysia as one of the developing countries. This paper also reviews expectations for the Brazilian economy in the next few years and what challenges awaits Brazil ahead. The aim of this paper is to explore the Brazilian economic situation and identify the trade opportunities for a country developing country like Malaysia. The literature review was supplemented by an interview done with the Malaysian Consul and Trade Commissioner of MATRADE in Brazil. The findings include some guidelines and suggestions for different categories of trade possibilities targets for Malaysian enterprises to tap the Brazilian market. Participating in Trade Fair and exposing the Brazilian to 'Made in Malaysia' products are among the recommendations concluded for this research.

Keywords: Brazil's Economy; Malaysian Trade; International Trade; International Business

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1. INTRODUCTION

Globalization is reshaping our cultures, our political, legal, and economic systems and affecting our standards of living. It alters the global pattern of trade and investment by expanding markets and multiplying production possibilities. The multifaceted impact of globalization on trade demands countries change the way they manage their trade arrangements. Bernard [1] summarized the key differences between trading and non-trading firms, where they demonstrated how these differences present a challenge to standard trade models and shows how recent 'heterogeneous-firm' models of international trade address these challenges. Export are different from non-exporters along several dimensions. The export-oriented firms are significantly larger than non-exporters in employment and shipments. They are more productive and pay higher wages and finally, exporters are relatively more capital and skill intensive than non-exporters. In addition to the size, there are there is also mass differences in the control method of two those firms.

Exporting firms would be labour-intensive rather than capital- and skill-intensive if they were specializing in goods consistent with comparative advantage in labour-abundant developing countries.

1.1. International Trade

In old trade theory, the welfare gains from trade are due to specialization according to comparative advantage. Contrary to that in new trade theory, the welfare gains from trade accrue from a combination of economies of scale and the expansion of product varieties available to consumers. Empirical analyses of trade liberalization at the firm level, however, provide evidence for an additional source of welfare gains: that is, aggregate productivity growth driven by the contraction and exit of low-productivity firms and the expansion and entry into export markets of high-productivity firms. This reallocation of resources from low- to high-productivity establishments raises average industry productivity. These welfare gains may be magnified if the increase in product market competition induced by trade liberalization leads to lower markups of price over marginal cost. In this case, the fall in markups and rise in average productivity both contribute to lower prices and higher real incomes.

Bernard [1] argues that, international trade flows to are small relative to the levels predicted by both old and new trade theory. In old trade theory, the amount of trade predicted by cross-country differences in factor endowments is a good deal greater than observed values of trade. In standard new trade theory models, all varieties are traded in equilibrium, a prediction that is at odds with the large number of zero bilateral trade flows observed in both aggregated and disaggregated trade data. The absence of trade flows can be explained by old trade theory in terms of prohibitive trade costs and complete specialization. But these explanations are not fully persuasive and do not explain why when positive trade occurs, some firms export while others do not. The question of export becomes moot as companies turn multinational to enter into foreign countries to jump the barriers of international trade [2]. Tintelnot [2] further found that bi- and multilateral trade and investment agreements would actual divert welfare gains between countries.

An issue of concern is that of international productivity differences. Leontif's paradox that questions the import and export decisions of labour vs capital intensive products has been debunked due to measurement and analytical issues [3]. Technology can now be transferred more easily especially by multinationals and specialization is no longer the province of a technologically advanced, capital-intensive economy such as the United States. Early theory by Vernon [4] show the international trade and investment patterns by tracing the life cycle of some products and to answer the Leontief's Paradox. This was based on several examples shows that for a location in which communication between the market and the executives directly concerned with the new product is swift and easy, and in which a wide variety of potential types of input that might be needed by the production unit are easily come by. In brief, the producer who sees a market for some new product in the United States may be led to select a United States location for production based on national location considerations which extend well beyond simple factor cost analysis plus transport considerations. The demand for a product expands at a certain degree of standardization usually takes place. Specialization can increase the variety of product and subcategories of the product which may multiply and the efforts at product differentiation increase, a growing acceptance of certain general standards seems to be typical. Vernon also added that at an advanced stage in the standardization of some products, the less-developed countries may offer competitive advantages as a production location.

1.2 International Trade Theory

The theories of international trade has evolved from comparative advantage where countries export goods they have the comparative advantage and import products where they are disadvantaged to product lifecycle theory; where companies will start to invest in foreign markets when the domestic market matures, then to Factor Proportion Hypothesis and now back to national competitive advantage. In the current climate of multilateral agreements where the lines between investment and trade are blurred and the basis of trade has been predicated on other issues such as ethics and climate, trade decisions are becoming more unpredictable than before.

Chakraborty [5] noted that foreign direct investments (FDI) has been found to have a positive impact on exports however, the impact may be in the short term as there are other factors influencing exports in the long run such as GDP, human resources and other resources. They also found that a negative FDI and export relationship were found in countries where there were weak credit support and when the FDI were intended to be market seeking in nature i.e. investment is made in a country for domestic consumption which is particularly true for another BRIC country, India.

More recent developments in the international trade scenario are the international production network (IPN) where investment cooperation and trade facilitation terms in trade agreements have a greater impact on cross border trade.

1.3 Economy in Brazil

Brazil's diverse industries include machinery and equipment, shoes, textiles, computers, aircrafts, cement, automobiles and parts, and computer durables as roughly one-third of the GDP. With significant operations in tin, iron ore, lumber, petrochemical and other minerals, Brazil continues to be a major world supplier of commodities and natural resources.

Besides goods, Brazil has tremendous sophisticated and diverse its services industry, including developed energy, banking, telecommunications, commerce, and computing sectors. The financial sector is considered secured when it provides local firms with a wide range of financial products, even though its interest rates are among the highest in the world. The largest financial firms however are Brazilian, where the two largest banks are government-owned.

The current scenario is one of economic stability and predictability. This has enabled Brazil to earn the investment grade status, according to the evaluation of major international risk rating agencies. The country attracts investment in sectors that are important for the sustainable development of the economy, including transport, energy, sanitation and housing. This influx of resources creates jobs and increases consumption. One of the governments' goals is to raise the investment rate to approximately 21% of GDP in 2013.

In the international arena, a report by the United Nations Conference on Trade and Development (UNCTAD) identified Brazil as one of the three leading destinations for foreign investment between 2010 and 2013. Despite the economic slowdown in Europe and the USA, Brazil ended 2012 with a net foreign capital inflow of USD52 billion, and the projection for 2013 is USD61 billion. The industry of petrochemical, mining, and agriculture were among the industry being focused on. Brazil's trade surplus hit a ten-year low in 2012 where the consumer markets dragging down sales abroad with the global downturn. In 2012, trade surplus which was at US$19.4 billion dropped 34.8 percent from the US$29.8 billion surplus from the year before. The same year also, total exports fell 5.3 percent to US$242.6 billion, down from US$256 billion in 2011, marking the first annual decline in exports since 2009.

The United States economy slow recovery and China slightly slowdown has diminished the demand for consumer goods. The iron ore prices decrease has also brought down the total value of Brazil's export. While as for the imports number, the fell however was only 1.4 percent which totaled US$223.142 billion compared to 2011. China was the main source of Brazilian imports in 2012 for the first time in history where the purchase of US$34.2 billion, compared to US$32.6 billion from USA before. This followed by imports from Argentina (US$16.4 billion), Germany (US$14.2 billion), and South Korea (US$9.1 billion). China has now became the main markets for the Brazilian exports with total of US$41.2 billion, USA with US$26.8 billion, and Argentina, which also imported US$18 billion of Brazilian goods. In fact, some of the Brazilian exports achieved record sales last year where US$6.595 billion sales were captured from soybean meal and US$5.359 billion of maize.

Brazil now possesses developed mining, agricultural, services, and manufacturing sectors. Development in infrastructure is being driven by public-private partnerships (PPP), whereas the Brazilian construction industry is being spurred by government investment. Nevertheless, the government's program to sell highway concessions to the private sector suffered an important reversal on September 13th when one of two roads concessions up for auction on September 18th received no bids from investors.

Brazil's economic growth will slow if the government fails to attract private investors for the government's ambitious program to sell infrastructure concessions to the private sector, including from Malaysia. In the construction segment, private sector interest has been decreasing since there is no momentum as economic activity remains cooling off, and the country did not do the necessary investments for the 2014 FIFA World Cup and the 2016 Olympic Games. In January 2007, the federal government's Growth Acceleration Programme (Programa de Aceleracao do Crescimento) or PAC, was unveiled with target to facilitate faster turnaround of construction projects which are in the pipeline. Oil and gas projects were funded as well as the transportation and sanitation sectors. This was mainly aimed to spur US$240 billion of infrastructure development from 2007-2012. US$832 billion were allocated for the expansion and modernization of Brazil's main airport Guarulhos as part of the infrastructure upgrades. Besides that, the government also announced the urbanization, slum rehabilitation and sanitation funds allocation to various states as part of other development. While between 2010 to 2014, an estimated of US$544.5 billion was allocated for the continuity of social programmes as the second PAC program, besides increasing public sector investment in infrastructure. PPP private investment has been beneficial at the regional level too. But as for the law, the regulations for foreign companies in Brazil are not liberal. To provide construction services Brazil, it was stipulated that foreign companies can either have a Brazilian partner or be established in Brazil. No negotiation though.

2. RESULTS AND DISCUSSION

Trade is one of the important source for any country for the contribution of one's GDP. The income generated from trading is crucial for each country to the extent that numerous new agreements were signed and Memorandum of Understanding (MOU) were sometimes appreciated as Memorandum of Agreement (MOA) itself. Relationships between countries were built to make sure these agreements continue so that the country's income would continue being generated subsequently. This is especially for developing countries like

Malaysia and Brazil. Even though Brazil's economic capital Sao Paulo is categorized as a developed city, Brazil as a whole is still developing and thus continue to seek long lasting trade relationship with other countries like Malaysia.

Latin America is among the fastest growing economies in the world currently. With a population of over 550 million and a GDP exceeding $3 trillion [6], the region is replete with natural resources and emerging service industries which make it globally competitive [7]. Seventeen of the world's largest 100 cities and commercial centers are located in Latin America [8], and Brazil is the 11th largest economy in the world, respectively [9].

With Brazil's economic reforms in the last decades, South America's prominent economy has been going through a transformation aiming growth in a substantial consumer market with a population of almost 200 million. The agricultural, mining, manufacturing and services sectors are well-developed, and the economy outweighs other Latino countries. Brazil is expanding its presence in the world economy market as one of the BRICs countries. It has also improved steadily its macroeconomic stability in 2003 by building up foreign reserves, and reducing the debt profile by shifting its debt burden toward real denominated and domestically held instruments. Brazil then became a net external creditor in 2008, and two ratings agencies awarded investment grade status to its debt.

However, despite the strong growth in 2007 and 2008, Brazil was hit by global financial crisis in 2008. For two quarters Brazil has experienced recession and its commodity-based exports dwindled and external credit dried up. Brazil was then recovered very quickly compared to other emerging markets. Consumer and investor confidence revived in 2010 and GDP growth reached 7.5%, which was the highest growth rate in the past 25 years. Even with the slower growth in 2012, Brazil overtook the United Kingdom as the world's seventh largest economy in terms of GDP. Nevertheless, concerns over the pace of economic activity, particularly in the industrial sector, continues to dominate the policy debate in Brazil. Throughout 2012, Brazil has experienced several economic ups and downs due to the fallout from the European debt crisis, slower growth by major trading partner China and domestic problems such as a manufacturing sector struggling with high taxes and a strong local currency.

Brazil's government has remained optimistic that growth of at least four per cent can be achieved after such a dismal 2012. According to analysts, Brazil's economy will likely grow

3.1 per cent in 2013, instead of 4.3 per cent as projected by commercial banks after investment levels dropped more than expected in 2012. To ensure there would be a consistent efforts to support the export, the Ministry of Development and Trade has introduced a new program to increase Brazil's manufactured exports. This is the Ministry's main agenda in 2013. Among the programmes are to introduce more financing assistance from the National Development Bank (BNDES) and also some attractive stimulus package to drive the infrastructure sectors. For 2013, the outlook for the Brazilian economy is project to be moderate. Despite the recent warming of the economies of developed countries, the government has tried a proactive approach in assisting the local companies.

In 2012, Malaysia was Brazil's 30th largest trading partner, while among ASEAN, Malaysia is Brazil's second largest trading partner. Although there will always be uncertainty in the domestic market, Malaysia's exports to Brazil would not be affect by the economic slowdown in the country itself as Brazil also traded with other Latin America countries. Malaysia's major exports such as processors controllers, petroleum oil, rubber gloves, electronic integrated circuits, palm kernel oil, parts & accessories and automatic data processing machines were expected to see positive results in 2013. Brazil's trade with Malaysia amounted to USD3.66 billion last recorded in 2012, accounted for 0.8% share of Brazil's global trade. Import from Malaysia amounted to USD2.09 billion, accounted for 1% share of Brazil's total imports. Processors and Controller was the main product imported from Malaysia in 2012 amounting to USD448.85 million or 21.6% share, followed by Parts and Accessories for Computer Units at USD197.39 million or 9.48% share. The other main imports from Malaysia were rubber gloves, parts for television, and electronic integrated circuits.

Malaysia's major exports destinations in 2012 however is the Republic of Singapore with USD$30,910.47 million, 13.6% shared. This followed by People's Republic of China, Japan, USA, and Thailand. Brazil in 2012 falls on number 25 with total of USD$1,087.50 million, which is 0.5% shared from Malaysian total exports overall. Department of Statistics, Malaysia in 2012 showed that Malaysia's total export by product sectors such as agriculture goods, manufactured goods, and mining goods. Agriculture goods exported were, cereal; crude rubber; hides, skins and fur skins raw; live animal and meat; palm oil, saw logs and sawn timber; seafood, fresh, chilled or frozen; vegetables, roots and tubers; other vegetable oil; and, other agricultures. Manufactured goods exported were beverages and tobacco; chemicals and chemical products; electrical and electronic products; jewelry; machinery, appliances and parts; manufacture of metal; manufactures of plastics; non-metallic mineral products, optical and scientific equipment; paper and pulp products, petroleum products; processed food; rubber products; textiles and clothing; transport equipment; wood products; and, other manufactures. While the third sector is mining good exports contains of crude fertilizers and crude minerals; crude petroleum; LNG; metalliferous ores and metal scrap; refined petroleum products; tin; and, other mining.

In 2012, the main Malaysian products exported to Brazil are characterized by value added products i.e. parts for electronic and electrical items. However based on the strength of the Malaysian industry and the rising number of inquiries, we can promote other 'Made in Malaysia' products especially those with technological advantages such as infrastructure development and management, medical disposable, rubber based products, transportation engineering services and others. In order to increase market position in Brazil, Malaysian exporters should offer good prices and high quality products to Brazilian importers. In addition to import duties, Brazil has other costs on imports, which makes the final price of imported products very expensive.

Business Expectations for the Next Four Years

Based on the last National Industry of Brazil (CNI) survey, 439 major companies in Brazil stated that the outlook of the economy for the year 2015 is not encouraging. Investors expectation is that reasonably low growth will continue through 2015, unemployment will increase and inflation will further rise. The economy is expected to remain pessimistic with an indication of slowing down in most of the industries. The government is expected to take several immediate measures to improve the current situation by implementing strategic mechanisms such as budget cutting and fiscal controls. It was mentioned that the majority of the companies want the government to revive the economy by making adjustment in the fiscal policy, reducing creative accounting and cutting government spending. These are expected to bring down inflation to the targeted number of 6.3 per cent. If these are implemented, the GDP projection will be increasing from 0.2 per cent in 2014 to 1 per cent in 2015, with an average increment of 1.6 per cent in the next 3 years until 2018.

Participants reported overall expectations for the annual performance of their business over the next four years are as follows; about 54 per cent of the respondents stated that the country's GDP will be between 0 to 1 percent. Their company's investment prospect for the next four (4) years is highly uncertain. Only 10 per cent will probably to increase their venture. Whereas 45 per cent of the companies have confirmed to lay off workers as a cost-cutting measure. 45 per cent will maintain the current number of staff and only 10 per cent will hire new staff or increase the number of employees. In terms of the direction of the country for the next four years, 61 per cent of the companies feel pessimistic about the country direction and only 16 per cent opined that the government will be more optimistic.

The business expansions look uncertain due to the outlook of the economy for 2015 and beyond. Companies expect this sentiment to continue until there are clear signs of more economic stability. Progress hinges on the strength of the USA economic recovery, the sustainability of its fiscal and trade deficits, and the course of its monetary policy.

Based on sectoral analysis, considerably more companies in the construction, hospitality, agri-business and information and communications sectors expect their business situation to be moderate with slight improvement. In the automotive, trade and wholesale sector, more respondents expect their business situation to be worse, as a result of the low market demand in the domestic economy. Only 10 per cent of the respondents expect to increase their staff in line with the company's expansion. It is noted that a significant proportion of companies in major industries such as automotive, construction, oil and gas, food & beverage, retail and whole sale expect their employment to decrease. Respondents in almost all sectors expect their selling prices or service charges to increase due to the higher taxes that will be imposed by the government. In particular, a significant proportion of respondents in the construction sector expect their tender prices to go up.

Challenges Ahead

There are several main challenges that will possibly influence the growth of investments if the country does not take effective efforts to improve the situation. Massive changes are needed to ease up the business process and effective mechanism to bring foreign investments. Malaysia is on track to become a developed nation by 2020 with GDP per capita of $9,766 in

2016 whereas Brazil's GDP per capita is \$8,651. The population size of Brazil makes it harder for Brazil to meet the \$12,000 threshold to become a developed nation. Brazil needs a major revamp on the investment policies to replace the current measures that have been regarded as too bureaucratic. There should be more opportunities for the local and foreign entities to expand their business with a consistent support from the government.

As the largest economy in Latin America, Brazil should be more aggressive in developing the domestic investments. This should be the priority to create employment and reduce inflation. The government should not rely on the protectionism to safeguard the local industries.

There is growing indication that the existing government's policy to protect its local industries may not be the long term solution to attract new investments. Inflation and household debt servicing costs are extremely high and loan defaults appear to have increased. Financial institutions are taking more cautious efforts in providing assistance to industry. Although this has not been the case as the government has reiterated their fullest supports towards foreign companies but it remains an issue. Despite criticism and accusations, certain measures are expected to continue particularly those strategic sectors that Brazil has the advantage against foreign products and services. At the same time it is important for the country to increase investment in education, improving the management of public spending, double the investment in infrastructure, as well as simplification and greater transparency in the tax structure. These are necessary to produce competent skilled workers and attract new investments.

However, for new foreign investors, they need to understand the high labour costs, taxes, and heavy bureaucracy that have long been a barrier to investment in Brazil. Foreign investors are still seeking tax breaks and other concessions from Brazil's government before committing to its expansion plan. Those who are new to the market are urged to work in partnership with a reliable partner who would be able to facilitate their venture.

3. CONCLUSION

One recommended alternative to venture in this potential market is participating in specific trade fair related to a particular economic segment. While participation in trade fairs in Brazil is relatively expensive, Malaysian companies are encouraged to explore the possibility of cost sharing in such activities through working with their trade associations in Malaysia. Buyers of industrial goods consider sales service as utmost importance. More and more large manufacturers are offering customer support service and good after-sales. Besides that, another important factor is quality control. To improve sales, small companies are seeking to implement the customer service policies and quality control. Malaysian companies interested in tendering for local projects must be consciousness that tenders are sometimes restrictive to attend several complex requirements.

‘Made in Malaysia’ have huge potential especially those with technological advantages. Products and Services briefed in the next item products representing opportunities and must be ventured together with a local partner due to the complexity of the local law and other restrictions. Gradually, Brazilian consumers are becoming much aware of these services need. Brazilian manufacturers of consumer goods, including food processors, now have customer support services, and toll free customer service telephone numbers. Obviously, there are many aspects to be seriously considered for Malaysia to explore new international venture in a BRIC country like Brazil. Perhaps the next step is also to tap the untapped market of not just this Latin country, but also the rest which are similar in terms of the needs and demand.

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