

The Effectiveness of International Trade Agreements for Restricting Tax Protectionism in Brazil

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Protectionism

- Why does protectionism exist?
 - Comparative advantages are the reason for trade.
 - Free trade promotes global efficiency, but harms less productive firms.
 - Local producers, unions and other interest groups trade political support for protection against more efficient players from abroad.
 - Protectionism is a state policy that seeks to neutralize the comparative advantages of foreign firms, at the expense of local consumers and foreign producers.
 - Tax protectionism distorts, through taxes, consumption and investment choices favoring local production.

Tax Neutrality

- Tax protectionism causes substantial welfare losses.
How to neutralize it?
 - Trade: avoiding import duties and discriminatory consumption taxes on foreign services and goods.
 - Investments:
 - Capital Export Neutrality (CEN): investment should face the same tax burden regardless of whether it is inbound or outbound. Requires worldwide taxation with foreign tax credits.
 - Capital Import Neutrality (CIN): the return of capital should be taxed at the same total rate, regardless of the residence of the investor. CIN requires that international tax rates be harmonized.

Tax Neutrality

- Tax protectionism causes substantial welfare losses.
How to neutralize it?
 - Labor (but also applies to capital):
 - Competitive Neutrality: taxes should not distort the matching of workers and jobs. This can be achieved: (i) via worldwide taxation, basically the same as CEN; (ii) via ideal deduction, requires uniform source taxation (residents and non-residents taxed either on a gross or a net income basis).

International Law

- The WTO is far behind.
 - The WTO does not concern investments, and allows trade-distortionary measures (i.e. MFN exceptions to developing countries, free trade areas and customs unions).
 - The prohibition of industry-specific subsidies does not prevent them to be applied across-the-board.
- Bilateral agreements, free trade areas and customs unions are thriving...
 - ...But they are essentially discriminatory, and may create trade diversion, leading to further welfare losses.

Brazilian Policy

- What is the Brazilian stance on tax protectionism?
 - Brazil has an overwhelmingly complex system that relies on industry-specific taxation, and is therefore innately distortionary.
 - CEN-like policies are adopted by taxing the worldwide income, generally allowing foreign tax credits. However, competitive neutrality is violated since residents and non-residents pay income taxes on different bases.
 - Imports are subject to indirect taxes that are not necessarily recoverable as credits.
 - Treaty overriding on services by levying a technology tax and not applying article 7.
 - Plenty of subsidies exist, some of them concerning exports, with a general exemption of indirect taxes.

Brazilian Policy

- What is the Brazilian stance on tax protectionism?
 - Brazil is a member of the WTO and MERCOSUR, and does not have a free trade agreement with any large country.
 - The ICC (2013) made a qualitative analysis of the Brazilian trade policy, and concluded that it is the closest economy among G-20 countries, scoring “below average” in trade openness and foreign investment openness, and “very weak” in trade policy.
 - All MERCOSUR members were badly evaluated by the ICC ranking. Trade diversion?
 - This requires empirical studies.

Brazilian Policy

- Perspectives.
 - Significant pressure by trading partners (especially EU, Canada and Japan) against protectionism.
 - Low GDP growth, low productivity, high tax burden and cumbersome compliance requirements has created significant pressure from local business for more openness and a simplified tax structure.