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**Session III: Industrial Policy and the Promotion of Domestic Industry – contribution from
Brazil (Seprac)**

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Session III: Industrial Policy and the Promotion of Domestic Industry

Automotive Industry Incentive Program

- Contribution from Brazil* -

1. Introduction

1. The Secretariat for Productivity and Competition Advocacy (Seprac) of the Ministry of Finance was called to analyze the adoption of a public policy that establishes:
 - mandatory requirements for the commercialization of vehicles in Brazil;
 - the “Rota 2030” Mobility and Logistics Program;
 - the Non-Produced Autoparts Regime.
2. In line with its assignment, Seprac focused on the possible anticompetitive effects arising from this policy that was submitted to the National Congress later on.

2. Background

3. The Incentive Program for Technological Innovation and Automotive Vehicle Productivity Chain (“Inovar-Auto”) was in force from 2013 to 2017. Its objective was (i) to provide better conditions to increase the automotive sector competitiveness, (ii) to produce safer and more efficient vehicles and (iii) to invest in supply chain, engineering, basic industrial technology, research and development.
4. Starting in July’2018, a new industrial policy for the automotive sector was in force, based on three basic axes, as mentioned above: (i) mandatory requirements for the commercialization of automobiles in Brazil; (ii) the “Rota 2030” *stricto sensu* and (iii) Non-Produced Autoparts Regime. As a matter of simplification, all three measures are known as “Rota 2030”, a program created by the Provisional Measure no. 843, as of July 5th, 2018, that applies a tax exemption for a five-year period. So, “Rota 2030” is considered the new automotive policy since that Inovar-Auto was due in 2017 and it will last until Dec’2023. There is a possibility to extend the program up to 2032 in case a successful development in innovation takes place.
5. Throughout 2017 and early 2018, the Ministry of Industry, Foreign Trade and Services organized and promoted meetings with the automotive sector and other government bodies to discuss and design the “Rota 2030”.

* This contribution was prepared by the Secretariat for Productivity and Competition Advocacy (Seprac) of the Ministry of Finance of Brazil.

6. Several governmental bodies participated in these meetings, such as the Ministry of Planning, Development and Management (MPOG); the Ministry of Foreign Affairs (MRE); the Ministry of Finance (MF); and the Brazilian Agency for Industrial Development (ABDI). The Secretariat for Productivity and Competition Advocacy (Seprac) and the Federal Revenue of Brazil (RFB) represented the Ministry of Finance.

3. Analysis

7. In order to assess the possible anticompetitive impacts generated by public policies, Seprac uses the OECD methodology compiled in the Competition Assessment Guidelines. The methodology consists to verify a set of issues in the analysis of the public policies impact on competition. In short, the anticompetitive impact may occur by: (i) limiting the number or variety of suppliers; (ii) limiting competition between companies; (iii) reducing incentives to compete and (iv) limiting consumer choices and available information.

8. The first section of program specifies that the Federal Government will establish compulsory requirements for the commercialization of new vehicles classified under the codes 87.01 to 87.06 of the Harmonized System (HS). Such requirements will be based on: (i) vehicle labeling, (ii) energy efficiency and (iii) vehicle safety. The Ministry of Industry, Foreign Trade and Services will monitor the compliance with these requirements.

9. The Federal Government will also reduce the excise tax subjected on the ex-factory vehicle price up to two percentage points per vehicle based on the criteria of energy efficiency and vehicle safety. In this case, it is worthy to mention that, in Brazil, the rate of this excise tax is 7% to 25%, according to the (i) fuel type and (ii) engine volume.

10. According to Seprac assessment, there is no perceived impact on competition in relation to the tax exemption and compulsory requirements, since the policy grants benefits and imposes obligations equally on all players in this relevant market. In that section, it should be highlighted that Seprac succeed on advocating that, in opposition to the original proposal, requirements that lead to discrimination against products in this relevant market, such as imported vehicles, should not succeed. Thus, the idea of requiring minimum investments in R&D was abandoned, which would go against the item A.3 of the OECD Guide by “limiting the ability of certain companies to provide good or service”.

11. The second section of the public policy creates the “Rota 2030”, which aims to encourage technological development, competitiveness, innovation, vehicle safety, environment protection and energy efficiency.

12. “Rota 2030” will qualify in the program companies that manufacture, commercialize or submit technological projects for the production in Brazil of new products or new strategic solutions for mobility and logistics. For this qualification, companies have to comply with minimum requirements related to (i) vehicle labeling, (ii) energy efficiency, (iii) structural performance, and (iv) R&D expenditures.

13. Thus, by complying with these requirements, companies will have a reduction on their corporate income tax. The incentives will be granted in the form of rebates on the taxable basis of the income tax in the sense that the company can deduct from its tax burden up to 35% of the expenditures made in R&D. In the case of investments considered as strategic, an additional benefit that reaches a total deduction of 45% will be applied.

14. In other words, every BRL 100.00 invested in the automotive industry (as R&D) under the program aegis, there will be a reduction of up to BRL 45.00 in the income tax to be paid. In this case, since the tax deduction was not granted on indirect tax, Seprac understood there were no anticompetitive effects.

15. In addition, it should be noted that this type of tax incentive in corporate tax was due to the fact that, in the previous Brazilian automotive policy (“Inovar-Auto” - due in Dec’2017), the benefitted companies obtained discounts on indirect taxes which could reach 30% of the ex-factory vehicle price. In this kind of tax exemption, imported vehicles was not able to comply with R&D investments requirements in order to get this 30% discount, which led the “Inovar-Auto” to an investigation in the World Trade Organization (WTO) for discriminatory treatment in disagreement with its principles.

16. The initial proposal for "Rota 2030" had similar aspects to Inovar-Auto's, but with substantial differences in their benefits magnitude. While in the final version the tax exemption was limited to 2% of the ex-factory vehicle price with no discrimination between domestic and imported vehicles, the initial proposal included differentiated rates of 10 to 15% of the excise tax rate based on the same requirements including minimal investments in R&D as percentage of the company sales. Therefore, companies that only import vehicle would not be able to reach this requirement, since they do not invest in R&D programs. This fact could lead to anticompetitive impacts in market and consumer harm. In this case, Seprac advocated successfully to not including this kind of tax exemption in the policy in order to not create an anticompetitive regulation in this particular market.

17. Finally, the third section creates the Non-Produced Autoparts Regime, which grants up to 2% of import tariff exemption for autoparts with no equivalent domestic production by demanding an equivalent investment in R&D. In this matter, Seprac did not observe any potential impact on competition.

18. In summary, with regard to “Rota 2030”, Seprac assessed there is no discrimination to players in this market, especially concerning imported vehicles, in opposition to the prior automotive policy (“Inovar-Auto”). In terms of tax expenditures, the Government expects the tax waiver will be limited to BRL 1.5 billion (aprox. USD 400 millions) annually.