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Twenty-Five Years of Trade Policy in Brazil: Continuity and Change

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September 2009

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1. Introduction

Brazilian trade policy and the political and institutional framework within which it is formulated underwent important transformations beginning in the early 1990s. Unilateral trade liberalization and the participation in an ambitious sub-regional integration plan were the movements that effectively put the new trade policy orientation into practice and wore down the protectionist import substitution model.

During that period, the international scenario also underwent some important changes with the conclusion of the so-called “Uruguay Round” and the strengthening of the regionalism symbolized by NAFTA and by the renewed impulse given to the European unification movement. In Brazil, trade negotiations earned never-before-seen relevance in the trade policy, primarily through preferential initiatives involving the Mercosur neighbors, but also the developed countries.

Against this political and institutional backdrop, Brazilian foreign trade was influenced both by changes to the trade policy as well as the evolution of the domestic macro-economic and foreign exchange policy scenario. In the 1990s, these factors combined to produce a heavy growth in imports and a mediocre performance in Brazil’s exports with the growth of Mercosur's participation as a destination for Brazil’s international sales.

Starting in 2002, the “maturation” of the structural transformations that began in the 1990s – the consolidation of a competitive agribusiness and the integration by the major companies of exports to their growth strategies –, the currency devaluation and the dynamics of the global economy converged to produce an export boom that substantially increased the Brazilian economy trade coefficient. This evolution also helped to demanding interests in the Brazilian trade negotiation agenda, until then remarkably defensive, generating non-negligible impacts on the country’s trade policy political economy.

2. Unilateral Trade Policies

2.1. Exports

The formal objective of the export support policy established in the mid 1960s was to increase and diversify exports without changing the structure of the import barriers, which represented a central element in the strategy of industrial development through import substitution.

The intensity of the use of the different policy instruments varied over time until the 1980s, when the degradation of the macro-economic situation and pressures by Brazil's main trade partners (primarily the United States) began to restrict the design and implementation of the export policy. Different policy instruments put into operation starting in the 1960s and 1970s were gradually phased out during the second half of the 1980s. This demobilization also affected the agency responsible for executing the policy, CACEX, which was dissolved in 1990.

When exports once again became a government priority – after the so-called "The Real Plan" – macroeconomic stability and multilateral commitments had already become consolidated as "restrictions" or requirements that should be considered when designing export policy instruments.

The recovery of an export support policy in the 1990s began with the financing area. Public lines of credit were gradually and selectively reestablished through FINAMEX (operated by BNDES) and PROEX (Export Financing Program) regulations.

However, during a period in which the foreign trade policy priority was linked to the liberalization of imports and the economic policy was practically reduced to the efforts to reduce inflation, the export policy occupied a non-prioritized position. Additionally, the maintenance of an attractive foreign exchange rate for exporters, together with periods of low dynamics in domestic demand, continued to drive international sales.

The situation lasted until “The Real Plan” began to drastically reverse this scenario. In 1995, the trade deficits reappeared, and with them, the concerns about the sustainability of the external sector area of the stabilization plan. Efforts to recreate an export policy, which until 1995 were incipient, began to intensify during the following year, due to the deterioration of the expectations for the trade balance performance within a scenario of reduced external financing supply.

The main components of this reassembly process were: (i) efforts to improve policy coordination; (ii) movements directed at the reduction of taxes on exports and (iii) the reestablishment of highly encompassing public mechanisms in the area of export financing and provision of guarantees for the granted credit (credit insurance and the Export Guarantee Fund - FGE).

The creation of the Foreign Trade Chamber – CAMEX, linked first to the Presidency of the Brazilian Republic and later to the Ministry of Development, Industry and Foreign Trade (MDIC), reflects government efforts to improve the coordination between the different agencies connected to foreign trade in Brazil. Time proved that CAMEX effectively improved the inter-governmental coordination –

serving as a space for dialogue and negotiation between different ministries and public agencies – although within certain limits.

In the area of export-related taxes, different tax reduction movements were undertaken starting in the mid 1990s. Despite such different initiatives over recent years, there are still problems related to export companies' accumulation of ICMS (value-added tax) credits, which reduces the profitability of their activities. This situation primarily affects those companies for which the input costs are a substantial component in the final calculation of product prices.

However, the main public support measures for exports adopted during the 1990s concentrated on the financing area. The public financing system for exports was reconstituted based on two programs: FINAMEX, coordinated by the Brazilian National Development Bank (BNDES) and PROEX, operated by *Banco do Brasil* on behalf of the Treasury Department. The two lines of financing (as well as the one focused on equalization of interest rates, in the case of PROEX) were significantly reinforced starting in 1996/1997 in terms of the budgetary resources they received, making them increasingly "horizontal" in terms of scope, or in other words, increasingly detached from sector priorities. To add to these financing mechanisms, an export credit insurance company was created in 1997, for the most part private, with the provision of public guarantee mechanisms for export credit, designed to cover political and trade risks over the medium and long terms (the Export Guarantee Fund).

The Brazilian National Capital Company Investment Support Program was created in 2002 within the sphere of the (BNDES), with aims at supporting the internationalization of Brazilian companies. This decision met the demand of export companies whose success in international markets – especially in the most demanding markets – depends increasingly on investments associated with the trade and distribution of their products.

2.2. Imports

Until the beginning of the trade liberalization process in 1988, the tariff structure in place in Brazil was practically the same as the one implemented 30 years earlier in 1957, when the replacement of imports was at its initial phase. At the end of the 1980s, the import penetration coefficient hardly passed 5% (and 3% in the transformation industry) and liberalization began cautiously in 1988 by eliminating the tariff redundancy, suppressing certain surcharges applicable to imports and partially eliminating the 42 special tax regimes in force. These measures decreased the average nominal tariff rate from 57.5% in 1987 to 32.1% in 1989 (Markwald, 2005).

Unilateral trade liberalization was extended in 1990 and concluded at the end of 1993, eliminating the extensive range of non-tariff border barriers and reducing the average tariff to around 13% at the end of 1993. In 1994, when "The Real Plan" was implemented, certain additional tariff reductions were applied and the average nominal tariff rate this year dropped to 11.2%.

Implemented during a worsening macro-economic crisis, with domestic demand down and the real exchange rate quite high, trade liberalization had little impact on the import flows and practically did not affect domestic demand until 1994. Another factor contributing to this phenomenon was the liberalization process which maintained a reasonable level of tariff escalation. It was only with the implementation of "The Real Plan," the consequent appreciation of the national currency and the expansion of domestic demand that the effects of trade liberalization were widely felt in the domestic market. From there on out, the opening of trade began to serve as an inter and intra-sector selectivity factor, discriminating between companies and sectors based on their capacity to adapt to a competitive environment.

On the aggregated level, this evolution increased protectionist pressures, which found backing in the macro-economic concerns of the policy makers. There was an "effective, although moderate, reversal of the trade opening process" (Markwald, 2005): in 1997, the average nominal tariff rate was 4.5 percentage points above that recorded in 1994. It was also starting in the mid 1990s that the appeal to instruments of contingent protection became more intense, primarily in terms of the antidumping mechanism.

The evaluation of how trade opening impacted Brazilian industry leaves it clear that liberalization was one of the most important factors affecting industrial performance in the 1990s, even though its impacts on the industrial structure were still limited. It directly helped to mold a business environment characterized by a level of market contestability much higher than that seen during previous decades. This made the search for boosted productivity and competiveness a central objective in business strategies. Additionally, trade liberalization represented an essential pre-condition for the drastic reduction in inflation levels after July 1994.

2.3. The Post-Crisis Unilateral Trade Policy

The emphasis on the measures designed to increase the offer and reduce the cost of export financing was once again seen in the Brazilian response to the international crisis. The initiatives adopted by Brazil in the trade policy area were more focused on expanding access, cutting export financing costs and reducing the tax and bureaucratic costs associated with trade activities. Despite the introduction and the swift suspension of the requirement for non-automatic import licenses, there were no relevant measures to increase the domestic protection against imports.

The emphasis on instruments designed to reduce costs and increase the availability of export financing results from the Brazilian government's expectation that the contraction of trade credit would be one of the main restrictive factors to affect Brazilian exports after the outbreak of the crisis. The initiatives to reduce financing costs also respond to the need to adjust the costs of the official lines of credit to match the reduced interest rates resulting from changes to the monetary policy. However, it is possible that there has been an increase in the subsidy component in public export financing initiatives.

On the other hand, the low emphasis on protectionist measures (defense of the national industry against imports) reflects the high number of items imported by Brazil, which began to fall sharply at the end of 2008. In fact, there was no increased demand for protection by the Brazilian industrial sectors.

3. Negotiated Trade Policy

The need to implement the commitments resulting from the end of the WTO "Uruguay Round" and from the creation of Mercosur was another fundamental turning point in the orientation of Brazil's trade policy during the first half of the 1990s. In both cases, Brazil assumed commitments that went far beyond those it had used to deal in trade negotiations until the mid 1980s – which were generally not very ambitious.

During the "Uruguay Round," the country consolidated the tariffs for its product universe, which meant the establishment of a maximum tariff protection limit that it could use as part of its protection policy. Even if the bound tariff levels had been relatively high – compared to those being implemented as a result of the unilateral tariff reform – and had left a high margin of comfort for increases in the applied tariffs, it was an important step toward the improved transparency and predictability of the protection policy.

Furthermore, the multilateral commitments advanced into non-traditional areas of trade negotiations. The country ended up changing its laws associated with intellectual property protection and trade defense, and was forced to respect certain limits when adopting industrial policy instruments.

However, the most representative change in the orientation of Brazilian trade strategies was the creation of Mercosur, an ambitious trade agreement designed as a customs union among four countries, with the free circulation of goods, services and production factors. The model adopted by the block would demand a higher degree of coordination between the trade policies of the member countries, which demonstrated their limited capacity for implementation, mainly due to the economic crises that affected the region at the end of the 1990s.

Ever since the creation of Mercosur, Brazil has been unable to implement trade agreements of relevant scope. Besides the free trade agreements signed together by Mercosur with Chile and Bolivia in 1996, and with the Andean Community countries in 2003 after a long negotiation period, the other negotiated agreements (Mexico, India and South Africa) have been highly restrictive in terms of product coverage and levels of preference granted and received.

It has been hard for the country to move forward in the world of regional agreements. With developed countries, Brazil's main interests are concentrated on those topics that make up the core of protectionism in these markets (market access and subsidies rules for agricultural products and more rigorous discipline to impose antidumping measures). At the same time, the Brazilian government resists negotiating rules and discipline in areas such as investment protection, intellectual property and services that have been incorporated by developed countries in most of the recent regional agreements.

In the initiatives with developing countries, there has been a limited demonstration of interest by Brazilian trade partners in advancing toward agreements that represent more encompassing trade liberalization. Generally speaking, these countries see Brazil as an important competitor with domestic producers. Accordingly, the agreements established cover only those products that already have lower import tariffs and which do not have any party-to-party sensitivities. As a result, the trade creation potential of such agreements is quite restrictive.

During the first years of the current decade, attentions were focused on the FTAA negotiations and those of the agreement between Mercosur and the European Union. The launch of a new round of negotiations at the WTO in November of 2001 generated the expectation that it would be possible for the country to play on the three game boards at the same time, maximizing the gains in its agreements with developed countries.

The deterioration of the economic environment of the Mercosur member countries was another factor that increased tensions in the intra-block relations during this period. Trade disputes between the member countries increased and decisions on pending topics involving the integration process continued to be successively put off. During this phase, international negotiations earned relevance in the block agenda due to the difficulties in developing topics associated with the consolidation and expansion of Mercosur.

The Lula Government has introduced gradual changes in the Brazilian trade policy to adapt it to the new objectives and priorities of the foreign policy and to domestic policy requirements. In the first place, there was increased resistance to negotiate regional agreements with developed countries, primarily the United States. Brazil has proposed the reformulation of the FTAA negotiation process in order to reduce the project's level of ambition. The process ended up by being paralyzed late in 2003. Despite efforts to close an agreement during 2004 with the European Union, it was not possible to overcome the main obstacles, which are largely related to divergences in the interests between the two blocks. The WTO turned out to be seen as the most adequate forum for negotiating trade issues with the developed countries.

Secondly, there has been an intensified reluctance to negotiate the non-strictly trade topics. With the increased concern to preserve the levels of freedom to implement autonomous industrial policies, the government begins to avoid negotiating disciplines of interest to developed countries. These include the protection for foreign investments, the access to public bidding processes or new rules for service trade. Gradually, the core of Brazilian protectionism shifted from the topics of market access to industrial goods – where Brazil's defensive position adopted a softer tone – to non-strictly trade topics like those mentioned above. On the other hand, Brazil also began to accept that rules of its demanding interest, such as antidumping measures and those for agriculture subsidies, be dealt with only in the multilateral forum.

The third relevant point in the current trade policy is the activism in bilateral negotiations with Southern countries. The argument that the international trade dynamics are found in developing countries and that the possibilities for a growth in trade flows with Northern countries are already depleted has led to the creation of new trade fronts – both within South America as well as with countries from other regions. Trade agreements with developing countries are presented as an alternative to the difficulties faced in the trade agendas with developed countries.

Nevertheless, the trade agreements on the South-South front, such as those negotiated between Mercosur and the Andean Community, India and South America, have also demonstrated clear difficulties. The agreement between Mercosur and the Andean Community is quite unbalanced in terms of gains of market access for the two blocks: while Mercosur offers the complete opening in five years for approximately 90% of the trade value, the Andean countries will only begin to open their markets for the majority of the products exported by Brazil six years after the agreement has entered into force. On the other hand, the agreements with India and South Africa produced very limited tariff preference agreements both in terms of the number of products covered, as well as the percentage of the granted and received preference margins.

Recently, in 2009, the Frre Trade Agreement between Mercosur and Israel entered into force in Brazil, after its approval by the Brazilian Congress. This is the only FTA in which the Mercosur countries participate with a country outside the Latin American region. Nevertheless, trade flows between Brazil and Israel have a very small participations in Brazilian total exports.

Difficulties advancing into the sphere of preferential agreements – both with developed countries as well as developing countries – ended up leading Brazilian diplomacy to concentrate its trade efforts on the "Doha Round," which had already earned a distinguished place in the ranking of Brazilian trade priorities, given the relevance that Brazil's foreign and trade policy has historically given to multilateralism. The importance that Brazil earned in the multilateral arena during the negotiations of the current Round has most certainly helped encourage this trade effort "focus" in the multilateral sphere over recent years.

4. The Trade Policy Political Economy in Brazil

The formulation of the trade policy in Brazil (whether through autonomous or negotiated tracks) essentially translates the characteristics of historically limited exposure to world trade (in relation to the GDP) and the strong protectionist tradition rooted between policy makers and business and trade union associations. These characteristics were only partially impacted by the trade liberalization of the 1990s. The truth is that, for the domestic requirements that mold the Brazilian trade strategy, there was much more continuity than rupture in the 1990s when compared to previous decades. Two characteristics appear to be especially important in terms of explaining the dominance of Brazil's defensive postures in the trade negotiations of the 1990s:

- the first involves the political economy of the liberalizing reform process in Brazil, and primarily, the primacy that the import-competing sectors were able to maintain in the area of trade reforms over export sectors and interests.

The specific characteristics of the trade liberalization put into practice by Brazil at the start of the 1990s generated a structure of protection for the industrial added value that was strongly heterogeneous in inter-sector terms. This benefited the same sectors favored by industrial policy and export support from previous decades: automobile, electro-electronic, textile and apparel and capital goods. The importance of this characteristic is further highlighted by the survival and creation of sector regimes that provided incentives for investment and production. These benefited, among others, the sectors already favored by high levels of trade protection during the post-opening phase.

- the second characteristic involves the fact that the foreign economic policy paradigm consolidated during the import substitution industrialization period remained hegemonic in Brazil, heavily affected by the liberalizing tendency that so characterized the economic policies of the 1990s and which were not reversed – at least not significantly – under the Lula Administration. This foreign policy model earned ample support during protectionist industrialization and was historically oriented by the guideline to "neutralize" the outside factors perceived as capable of hindering the objectives of national economic development and the consolidation of industrial capacity. These were considered crucial conditions for ensuring the country could operate autonomously in the international system. In this area, continuity prevailed without any ambiguity during the phases preceding and following liberalization.

In Brazil's case, the weight of national development objectives within the paradigm of foreign policy cannot be minimized. As observed by Soares de Lima (2004), in Brazil's history the definition of foreign threats and perception of foreign risks were essentially linked to economic vulnerabilities more than security-related concerns. This led to the perception – as disseminated among elites – that the main function of foreign policy is to reduce this type of vulnerability and "open the space" for development policies.

In this sense, foreign policy was strictly subordinated to the objectives of economic development. In the area of trade, this produced a vision in which the North-South relation plays a central role not only in explaining the difficulties Brazil faces to reach its economic objectives, but also in defining the parameters that orient the establishment of the alliances and coalitions necessary to "leverage" Brazilian interests within the international sphere.

In Brazil, the tendency toward liberalization that affected economic policies in Latin America during the 1990s only partially questioned the policy paradigm inherited from the import substitution period. As far as trade negotiations go, the protectionist paradigm continues to be supported by an extensive coalition of bureaucrats and business associations from the industrial sector, which played a central role forming national trading positions in the area of trade and investment – both under presidents

Cardoso and Lula. The main consequence of this hegemony is that, even though it has become engaged in several trade negotiation initiatives, Brazil systematically adopted defensive positions during these processes.

Nevertheless, this scenario – known to be resistant to changes – has presented some significant fissures over recent years. Indeed, Brazil's economic evolution starting in the 1990s has led to the emergence of less defensive interests and visions in relation to the perspective of Brazil's international integration – both in the private sector as well as with public agencies. The determining factor for this change is the consolidation of a strongly competitive exporter sector with geographically diversified offensive interests. For the most part, this "competitive block" mingles with agribusiness and with the mineral extraction sectors, but it tends to include increasingly more diverse manufacturing segments.

From the beginning of the current decade, the "maturation" of the structural transformations that began in the 1990s – as the consolidation of a competitive agribusiness and the major export companies' integration with its growth strategies –, as well as the dynamics of the global economy and the Chinese appetite for commodities converged to produce an export boom that substantially increased the Brazilian economy trade coefficient.

The Lula Administration has increased the level of foreign policy ambition, seeking a greater role in the international forums. It has also imposed an important change in terms of the relationship of functionality between Brazil's foreign and trade policies compared to the previous period.

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