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The political economy of trade policy  
in Brazil: will it ever change?

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# The political economy of trade policy in Brazil: will it ever change?

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## 1. Introduction

This paper discusses the political economy of trade policies in Brazil, focusing on the period post-unilateral liberalization undertaken in the early 1990s. The level of tariff and nontariff protection that resulted from liberalization was significantly lower than the one prevailing in the pre-liberalization period, but industrial and trade policies in the post liberalization era have not changed a major feature of the long-lasting protectionist policies: the high degree of intersectoral discrimination in favor of import-competing industries.

At the same time, Brazil's foreign policy paradigm, dating back to the 1960s, was only marginally affected by the liberalization trends of the 1990s. Trade strategies continued to be designed in accordance with the broad political framework defined by the basic assumptions of the foreign policy put in place during the long period of protectionist industrialization. Hence, it is not by chance that, despite the fact that Brazil entered into many trade negotiations during the late 1990s and the beginning of the 2000s; these have generated few economic results.

But, since the beginning of the century, Brazil's foreign trade profile is undergoing changes that impact ideas and interests relevant in the arena of trade and industrial policies. These changes have not been able to comprehensively challenge the hegemonic paradigm of policy, but they interact with perceptions on the global

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economic trends to generate criticism from relevant actors. The policy issue raised by this questionings refers to the actual (and prospective) functionality of the policy preferences expressed by Brazil's trade policy *vis à vis* the "real" dynamics of the relationships between Brazil and the world.

The paper proceeds in three sections, beyond this introduction. The following section discusses the political economy of trade policies in Brazil, focusing on the role of domestic factors in explaining the prevailing continuity in trade policies during the 1990s, despite the liberalization episode of the early years of that decade. The subsequent section describes the evolution of Brazil's foreign trade in the last fifteen years, stressing its impacts on the political economy of trade policy. The forth section presents some conclusions.

## 2. In the name of Industry: the Political Economy of Trade Policy in Brazil

In the last fifty or sixty years, Brazil underwent deep economic, social and political changes. A stylized historical background of the economic phases that Brazil went through since the Sixties should include:

- an extensive process of industrialization based on the import substitution strategy combining high levels of tariff and non-tariff barriers with a fairly liberal FDI regime. In the early 1980s, Brazil had been able to deploy a diversified and domestic market-oriented industrial structure. As a result of its intense efforts to promote industrialization, the country had "an industry much larger than that of countries with level of development, population, (...) and technological intensity similar to ours" (Bonelli and Person, 2011). The import-substitution strategy was adopted by civilian governments and deepened by the authoritarian regime;
- a long period of macroeconomic crises, from the early 80s to the mid-90s, which gradually led Brazil to hyperinflation. The transition to democracy took place

during this period and civilian governments had to deal with the escalation of inflation rates and economic stagnation during almost one entire decade;

- an episode of macroeconomic stabilization *cum* trade liberalization in the first half of the 90s. Unilateral trade liberalization and the setting of a subregional integration agreement (Mercosur) preceded the adoption of a successful macro stabilization program (Plano Real). Privatizations and other microeconomic reforms were included in the menu of public policies;
- the "emergence years", which largely coincided with Lula's terms, when Brazil's international prestige grew strongly; and
- the "new hard times", combining slow growth, fiscal deterioration and a deep crisis in the industrial sector.

### 2.1. In trade and industrial policies, continuity prevails

There is no doubt that, from the adoption of the import substitution model as the industrialization strategy, the main shift in Brazil's trade and industrial policies was the unilateral liberalization initiated in the late 80s and deepened in the early 90s.

Until the beginning of the trade liberalization process, the tariff structure in place in Brazil was practically the same as the one implemented 30 years earlier in 1957, when the import substitution strategy was at its initial phase. At the end of the 1980s, the import penetration coefficient hardly passed 5% (and 3% in the transformation industry). The liberalization reform began cautiously in 1988 by eliminating the tariff redundancy, suppressing certain surcharges applicable to imports and partially eliminating the 42 special tax regimes applied to imports in force. These measures decreased the average nominal tariff rate from 57.5% in 1987 to 32.1% in 1989. Unilateral trade liberalization was extended in 1990 and concluded at the end of 1993, eliminating the extensive set of non-tariff border barriers and reducing the average tariff to around 13%. However, despite the relevance of this policy shift, a major feature of the trade policy implemented since this liberalization episode—as compared to the pre-liberalization period—has been continuity.

A broader view, encompassing the last decades, would shed light on a track of policy continuity as an earmark of Brazil's trade (and industrial) policies, in contrast with the evolution observed in other Latin American countries, where ruptures (e.g. Chile), a continuous liberalization path (e.g. Mexico) or high volatility (e.g. Argentina) prevailed.

In fact, the Brazilian unilateral trade liberalization episode generated a structure of protection based on tariff escalation. Higher tariff rates protected the same sectors favored by trade and industrial policies from previous decades under the import substitution strategy: automobile, electro-electronic, textile and apparel and capital goods.

Continuity went far beyond the specific features of tariff reform, as many of these sectors also benefitted, in the immediate aftermath of unilateral liberalization, from the setting of new sectoral regimes providing incentives for investment and production. Taking again a longer-term perspective would allow us to perceive, in the twenty years elapsed since the unilateral liberalization episode, the continuity of trade and industrial policy objectives and instruments owing to the import-substitution model, although the combination of the policy tools and the intensity of protectionism have certainly varied over time.

In Brazil, the liberalization winds that impacted the economic policies in Latin America during the 1990s only partially challenged the policy paradigm inherited from the import substitution period and the economic and social coalition that sustained politically this model. Therefore, it is not by chance that the 1990s' episode of unilateral trade reform did not trigger a decisive move away from the protectionist tradition and was far from generating a dynamics of trade liberalization leading to a deep revision of the dominant pattern of Brazil's integration to the international economy.

An additional example of policy continuity can be found in Brazil's participation in trade negotiations. As far as these negotiations are concerned, the protectionist

paradigm continues to be supported by an extensive coalition of bureaucrats and business associations from the industrial sector. These players had a central role in crafting national positions in the area of trade and investment international negotiations – be it under presidents Cardoso, Lula or Rousseff. The main consequence of this hegemony is that, even though it has become engaged in several trade negotiation initiatives, Brazil systematically adopted defensive positions.

## ***2.2. The role of domestic factors in the political economy of trade policy***

How to explain this continuity in trade and industrial policies in Brazil? Which factors account for the strong resistance of protectionism in Brazil? Why trade liberalization is not included in the wide menu of policies geared at the industrial sector – despite the growingly noticeable failure of these policies in addressing the crises that the industrial sector is going through?

In the case of Brazil, domestic factors play a central role in the evolution of public policies, even those that deal with the interface between Brazil and the international economy. Two domestic factors seem especially important in explaining continuity in Brazil's trade and industrial policies (Motta Veiga and Rios, 2010; Motta Veiga, 2008; Motta Veiga, 2007).

The first one refers to the weight of non-economic sources of preferences (Jamal and Milner, 2013) or ideas (Rodrik, 2013) in shaping public policies. Here the central role of ideas points to the resilience of the paradigm of foreign economic policy consolidated during the period of import-substitution industrialization. This paradigm survived the liberalization episode of the 1990s and remains the hegemonic set of ideas in Brazil applying to policies dealing with Brazil's integration to the world economy.

This set of ideas lies on two pillars.

- in the domestic front, the identification of the industrialization process to the “national economic project” and to “development” – the ultimate economic goal of an underdeveloped country – a view crafted during the import substitution period and widely shared by politicians, academics, business and trade unions.
- in the external front, the Brazilian perception of the world economic order and international regimes as expressions of developed countries interests – as opposed to developing countries aspirations – and as threats to the “autonomous” industrialization project (identified to development). In this view, the North-South cleavage plays a central role, not only in explaining the difficulties faced by Brazil in the international economic arena, but also in setting the parameters for the alliances and coalitions that it sought in the international economic arena. The paradigm of foreign economic policy – not only trade policy – which derived from this perception was historically driven by the objective of “neutralizing” external factors that might jeopardize national economic development and the consolidation of the industry — conditions perceived as indispensable for the country to act autonomously in the international system.

The robustness of the foreign economic policy paradigm in defining trade policy objectives and instruments could not be minimized in the case of Brazil. In Brazil’s history, the definition of foreign threats and the perception of external risks by its elites relates essentially to economic vulnerabilities rather than to security concerns. This led to a perception—widespread among these elites—that the main function of foreign policy is to reduce this type of vulnerability and to “open up space” for national development policies<sup>1</sup>.

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<sup>1</sup> Referring to the case of India, Rodrik (2013) quotes Mehta And Walton (2012), who “describe the Nehruvian Cognitive map that shaped India’s development path in the decades following independence: the need for a big investment push, suspicions over the private sector, emphasis on the leading role of capital goods, and export pessimism all derived from ideas about how a market system worked (or failed to do so)”.

The second domestic factor that accounts for the continuity observed in Brazil’s trade and industrial policies points to the interests’ dimension of the political economy of liberalization and reforms. The relevant point here is the primacy that import-competing sectors managed to maintain in the area of trade policy *vis à vis* the exporting sectors and interests, from the liberalization episode of the 90s’ until today, and this despite growing evidence that the industrial sector lacks competitiveness and is gradually losing relevance in the Brazilian economy.

Markwald (2001 and 2006) sheds light on the existence of a set of import-competing sectors that benefit from high levels of protection and make intense use of the mechanisms of public policy (high tariff rates, special import regimes, credit incentives, etc.) , before and after unilateral trade reform. Automobiles, electrical and electronic equipment, rubber and plastics, textiles, and clothing are among these sectors.

These sectors concentrate a large share of the stock of foreign direct investment in Brazil, and their trade agenda combines the defense of public policies to foster exports and a resistance to negotiating tariff reductions in multilateral and preferential forums. They played the protagonist role in the political economy of trade policy before the unilateral liberalization of the early 1990s and were able to keep this central position afterward.

### ***2.3. Swings in continuity: from the “era of emergence” to the “new hard times”***

The fact that two domestic factors have played the central role in shaping trade policy’s objectives and instruments for the last decades does not imply that the evolution of the policy has been immune to other influences and conditioning factors during this period. A good example for the emergence of new conditioning factors can be found in the first decade of the new century – until 2008 – a period which brought new actors and new sources of policy preferences to the stage of Brazil’s trade policy.

Indeed, in the first years of the new century, less defensive interests and visions related to Brazil's international integration emerged – both in the private sector as well as with public agencies. The determining factor for this move has been the consolidation of a competitive exporter sector with geographically diversified offensive interests, which strongly benefitted by the emergence of China and its enormous demand for commodities<sup>2</sup>. As a consequence, this “competitive block” was essentially composed by the agribusiness sectors.

The driving force behind this shift was not a voluntary decision from the government, as was the case with the liberalization episode of the 90s, but rather structural changes in the agricultural sector in Brazil, on the supply side, and in the global economy, on the demand side. The agribusiness sectors put pressure on the government to negotiate trade agreements with developed countries, especially with the European Union, one of its main markets.

New interests and new ideas appeared on the trade policy arena, pushed by a positive view of the opportunities opened to the Brazilian agriculture in the wake of globalization. In this view, the mitigation of external risks and threats associated to the international competition – historically the main goal of Brazil's foreign economic policy – does not match the offensive interests of its large and dynamic agribusiness<sup>3</sup>.

In the domestic policy arena, these views echoed the widely spread perception – in the international sphere – of a long-lasting shift of economic power from developed to developing countries, in particular to the large emerging countries, among which

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<sup>2</sup> “The performance of the agribusiness sector has been outstanding; exports in these sectors grew at an annual rate of 16 percent between 2001 and 2005. The diversification of exported products and the geographical destinations of exports has been a major feature in the recent performance of the agribusiness sector. Between 2000 and 2005, agribusiness exports to developing countries showed an average annual growth rate of 26 percent, while exports to developed countries grew at an annual rate of 13 percent. Currently, Brazil ranks first among world exporters of sugar, ethanol, beef, chicken, pork, and coffee. Brazil is also one of the top four exporters of soy, orange juice, and cotton” (Motta Veiga, 2008).

<sup>3</sup> In the international arena, this optimistic view was relayed by the widely spread perception of a long-lasting shift of economic power from developed to developing countries, in particular to the large emerging countries, among which Brazil.

Brazil. As a paper written in 2008 puts it, “at the global level, there is a growing perception that Brazil will be one of the most important players in the twenty-first century's world economy, together with the other BRIC countries (...). This perception is nurtured by the country's growing weight as a great global supplier of food, the key role it plays in multilateral trade negotiations, and the realization that it will be called to play a relevant role in addressing energy and environmental issues being assigned priority status on the international agenda” (Motta Veiga, 2008).

This new set of interests and ideas was influential in Brazil's stance in the Doha Round, at least until 2008, and strong enough to provoke a fierce policy debate on the Brazilian strategy of trade negotiations and, in particular, on the alleged (by the critics) subordination of trade and economic objectives to an “autonomist” foreign policy<sup>4</sup>. But it was not able to substantially shift the balance of power in the trade policy arena and generated no substantial move or output, as for instance the conclusion of bilateral negotiations between Mercosur and the European Union. The fact that the emerging offensive stance was confined to agricultural sectors and was not shared by any relevant sector in the manufacturing industry explains, at least partially, why this preferences shift fell short of provoking real impacts in Brazil's (unilateral or negotiated) trade policy.

Since then, the international economic crises and its impacts on the developed countries, together with the astonishing growth of commodities prices and exports to China and other Asian countries reduced the pressure for trade negotiations and, more broadly, for a new way of looking at the integration of Brazil to world economy coming from the export-oriented sectors of the economy.

On the contrary, what followed, during the first term of Rousseff, was the “restoration” of a full-fledged protectionism in trade and industrial policies, which

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<sup>4</sup> In 2006, the Confederação Nacional da Indústria (CNI, National Confederation of Industry), in a document addressed to the presidential candidates, proposed a strategy of trade negotiations whose priorities were based on explicit economic criteria: the dynamism and size of the markets, and the level of barriers to Brazil's exports.

only confirms the resilience of the set of ideas and interests inherited from the import substitution period.

The shift towards a more protectionist stance in the trade policy began to show up in the beginning of 2010, following a sharp increase in Brazilian industrial imports (42,2% over 2009) and the expressive reduction of the share of manufactured goods in Brazil's exports, from 55% in 2003 to 39%, in 2010 (Rios and Motta Veiga, 2014). The Government has become more and more sensitive to the import-competing sector pressures, introducing many protectionist measures explicitly aimed at defending the domestic industry.

Although Brazil has become, in the last few years, the “world champion” in the use of antidumping measures<sup>5</sup>, the coming back of protectionism under Rousseff was implemented principally through industrial policy measures. These measures were aimed at provoking the reduction of imports and their replacement by domestic production (import substitution strategy).

Rousseff's successive industrial policies included the expansion of public credit through BNDES with subsidized – and even negative, in real terms – interest rates; dissemination of domestic content requirements for access to official credit and tax incentives or for participate in biddings in areas such as oil and gas; broad preferences for local companies in government procurement and a new auto regime based on protection, domestic taxes' discrimination against imports, etc.

The intensification of the requirements of local content in different instruments seems to be one of the main features of the industrial policies adopted under

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<sup>5</sup> In Brazil, antidumping measures have traditionally benefitted highly concentrated intermediary sectors, like chemicals and steel. As pointed by Araújo Jr. and Miranda (2008) “ more than half of the 247 cases opened (...) were to protect domestic monopolists; in 26 percent of the cases, the petitioning industry was a duopoly; and in a mere 9 percent of the petitions was the number of participating firms higher than six.” The protection provided by antidumping measures to these sectors supplement the one guaranteed by the relatively high levels of tariffs - as compared to other developing countries - applied to them in Brazil (see, for example, Baumann and Kume, 2014).

Rousseff, affecting not only trade policy, but also the FDI regime as the incentives for FDI have been drafted in a way to make their application contingent to (high) levels of national content and to technology-intensity.

Inter-sectoral discrimination in the allocation of investment and production incentives and subsidies, as well as of protection from imports, was another major feature of Rousseff's industrial policies. The auto sector benefitted from a new investment regime, capital goods sectors were the main target of the subsidized lines of public credit through BNDES/FINAME and capital-intensive intermediary goods sectors received additional protection from imports through antidumping actions and temporary increases in tariffs.

In the area of trade negotiations, the reflection of these new protectionist winds has been the lack of interest in moving forward with the “in progress” initiatives like the EU-Mercosur free trade negotiations. More recently, even the conclusion of the Doha Round of the WTO – the almost exclusive focus of Brazil trade negotiation agenda in the years preceding the international crisis lost its appeal.

### 3. Brazilian foreign trade and the evolution of interests and ideas on trade policy

Industrialization has been identified to the main economic project in Brazil – development – and the “cognitive map” that shaped the idea of industrialization combines a high level of intersectoral discrimination by public policies (through protection, subsidies, etc), which expresses the preference for “high-technology” and capital-intensive sectors, to a strong orientation towards the domestic market. Competition – be it domestic or external – has been accorded a relatively marginal place in this “cognitive map”.

Trade policies in Brazil have been devised and managed as instrumental to the promotion and the defense, in good and hard times, of the Brazilian industry. The “industrialist” set of interests and ideas remains largely dominant in Brazil and the explicit goal of trade (and industrial) policies has been, in the last years, to further substitute imports and to protect the industrial capacity installed in Brazil.

However, the recent evolution of the Brazilian foreign trade suggests that reaching the “explicit goal” of trade policy is becoming harder (and costlier). Domestic and external structural changes are impacting the cohesion of the “protectionist block” and pushing the Brazilian economy and its industry towards more integration to the world economy. In this sense, one plausible hypothesis is that current policy preferences in the field of trade policy are becoming less and less functional for the real dynamics of the Brazilian industry and its relationships with the world.

These changes are beginning to influence trade policy preferences, through ideas and interests – especially among some private actors – but as happened in the middle of the first decade of this century, they still seem far from having a real impact on the political economy of trade policy. The set of interests and ideas of the import-substitution strategy remains largely dominant among domestic stakeholders and, in such a context, the current economic difficulties faced by the

Brazilian economy only strengthens the arguments for protection and defense of the installed industrial capacity.

#### ***3.1. Brazil's international trade in the XXI<sup>st</sup> century: from the export boom to the import surge***

Since the beginning of this century, Brazil is undergoing relevant changes in its foreign trade. Such changes involve the composition and geographic destination of its exports, as well as the dynamics of imports' growth. They became one of the factors which are reshaping the map of comparative advantages among sectors and redefining the relationship of different economic sectors, and in particular of the industrial sector, with the rest of the world. Their impacts on the political economy of trade policy are still very limited but they are noticeable in the field of ideas and interests related to trade policy.

The first years of the century registered an impressive growth of exports. From 2000 to 2005, the average annual growth of exports reached 23%, leading some analysts to refer to an “export boom” (Iglesias and Rios, 2010). Between 2002 and 2005, the value of exports practically doubled, jumping from US\$ 60 billion to US\$ 119 billion. Export quantities grew faster than prices and high growth rates benefitted non only primary goods (58.1% between 2002 and 2005), but also manufactured goods (56%, during the same period). The export coefficient of the Brazilian economy (export/GDP) grew from 16.7%, in 2000, to 22.4%, in 2005.

This trend was not sustained from the second half of the decade on. Between 2005 and 2010, the average annual growth of exports was 14,1% – far below the one observed in the previous five years – and between 2010 and 2014 this rate fell further to 2,3%. The export coefficient fell after 2006, remaining since then below 20% – in the third quarter of 2014, at 19.4%.

Brazil has traditionally a quite diversified profile in term of its exports' trade partners and product composition. In both dimensions, changes have not been

minor since the beginning of the century. As for trade partners of its exports, China consolidated as the main destination country for Brazilian goods. In 2000, exports to China responded for 2% of total exports. In 2010, they represented 15.2% and, in 2014, 18% of this total. The share of the European Union and the US were significantly reduced during this period (from 28% to 19%, in the case of the EU, and from 24% to 12%, in the case of the US). The same occurred with Mercosur, whose share in Brazil's exports had reached 18% at the end of the 1990s, falling to 14% in 2000 and to 9% in 2014.

As far as the product composition of exports is concerned, manufactured goods became majoritarian in 1981<sup>6</sup>, a situation which did not change until the second half of the first decade of the XXI<sup>st</sup> century. In 2000, 59% of Brazil's exports were composed of manufactured goods. However, in 2005, this share in exports had contracted to 55%, a trend that accelerated strongly since then. In 2014, the manufacturing industry was responsible for barely more than one third (35,6%) of Brazil's exports. Conversely, the share of primary goods in total exports grew continuously since 2000, coming from 22.8% to 48.7%, in 2014.

There is an important feature that distinguishes Brazil's export flows with its main trade partners: the sectoral composition of the Brazilian exports. While the Brazilian exports to China are concentrated in (mineral and agricultural) commodities, trade with Argentina and South America is more intensive in manufactured goods. The United States used to be an important destination for Brazilian industrial products, although the Brazilian companies have been losing market share to the Chinese in that market.

Hence, shifts in the geographical destinations and in the product composition of exports are intertwined trends. The growing share of China as a market destination

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<sup>6</sup> In 1964, manufactured goods represented only 6,8% of Brazil's total exports, growing to 20% in 1971/1972 and to around 50% at the beginning of the Eighties. In 1984, the share of manufactured goods in exports reached 56%, remaining, until the end of the Eighties around 54/55% (Motta Veiga, 1998).

for Brazilian exports goes together with the boom of commodities exports, while the poor performance of industrial exports is related to the diminishing share of Mercosur and the US as market destination for these exports.

There has been a process of "primarization" of the composition of Brazilian exports, although the growing share of primary products in total exports can be partially explained by the significant growth in the prices of commodities exported by Brazil. When prices are taken into account, it appears natural that the relative share of the industrial sector in the country's exports has fallen during this period.

However there is more than the impacts of commodities prices in this evolution as most industrial sectors showed a tendency to have their revealed comparative advantage reduced in the recent period. In many cases, the loss of comparative advantage begins before the period of boom in commodity prices. The "primarization" process is expressed not only through the growing share of primary goods in the total exports, but also by the growth of the participation of the industrial sectors intensive in natural resources within industrial exports (Rios e Araújo Jr., 2012).

As an assessment of the performance of Brazilian industrial exports, according to the intensity in the use of production factors, stresses, one of the main features of the performance of Brazilian industrial exports during the first decade of the century has been "the relative favourable performance of Brazilian exports of goods intensive in natural resources. The exports of these products show gains in their global market share throughout the decade, while the labour-intensive sectors see their global market share shrink. When comparing the market share of Brazilian labour-intensive manufactured goods in world trade between the beginning and end of last decade, there is a loss of about 25%. R&D-intensive goods also lost their share, but in a much lower magnitude" (Rios e Araújo Jr., 2012).

On the import side, the evolution observed along the first fifteen years of the century contrasts strongly with the exports performance. The first five years when

an “export boom” took place were, on the import side, characterized by modest average annual growth rates (6.4%, between 2000 and 2005, against 23% on the export side). The import coefficient of the Brazilian economy (measured by the ratio between imports and apparent consumption) fell from 18%, in 2000, to 16.3%, in 2005, again in sharp contrast with the growth in the export coefficient observed during the same period.

Things changed strongly from 2005 on as imports skyrocketed in two phases, interrupted by the poor performance of 2009, an effect of the irruption of the international crisis in the second half of 2008. Between 2005 and 2008 imports grew by 135% and between 2009 and 2013 by 87.5%. Meanwhile, exports were rapidly losing dynamism and trade surplus shrank in the last years until it became a deficit in 2014. Import coefficient grew to 17.5%, in 2010 and kept a growth track since then, reaching 21.9% in the third quarter of 2014.

Also for imports, the composition of trade partners went through important changes, in similar directions of those observed on the export side. China became the first individual provider of goods to Brazil (with a share of 16.3% in 2014 against 2.2%, in 2000), Mercosur lost relevance (14% and 7.5%, respectively) and the shares of the US and the EU were also reduced, although more deeply in the case of the former (from 23.1% to 15.3%) than the latter (from 26% to 20.4%).

The product composition of imports has been, in the last fifteen years, more stable than on the export side. Brazilian imports were, at the beginning as well as at the end of the period, dominated by goods used for industrial production in Brazil: intermediate goods and capital goods. Together those two categories of goods represented around 75% of Brazilian imports in 2000 and 66% in 2014. Oil and fuels have a share that oscillates according to international oil prices, but always below 20%. Consumer goods accounted for 13.2% of total imports in 2000 and their share rose in the last few years, reaching 17%, in 2014. Therefore, even in a context of rapid import growth, only a small part of imports are made of consumer goods.

### **3.2. New trends in foreign trade and the political economy of trade policy**

The aggregate output of the evolutions observed in Brazil’s trade flows since the beginning of the century has been a move from an optimistic view on the perspectives of Brazil in a globalized economy, which emerged around 2005/2006, to a pessimistic diagnosis of Brazilian industrial competitiveness and the consequent adoption of a wide array of protectionist trade and industrial measures.

However, the “full restoration” of the logic of the import-substitution strategy under Rouseff does not intervene in the same context where import-substitution strategy was deployed. Ideas and interests are moving, reflecting the impacts of some inter-related evolutions that shape the current status quo in the field of foreign trade – and are likely to continue to do so in the next years. Some of these factors are associated to structural shifts in the economy and are likely to have long-lasting impacts on the relationships between Brazil and the world economy and on the policy arena where economic and non-economic preferences emerge.

- *The consolidation of a pattern of international specialization based on a set of sectors intensive in natural resources.* Comparative advantages of the Brazilian industry are growingly concentrated in such sectors, which include not only the modern and competitive “agribusiness” sectors, but also manufacturing sectors such as pulp, food and beverages, etc. Other industrial sectors had in general a poor export performance in the last years. Besides, they lost domestic market-share when competing with imports, making it explicit their lack of competitiveness.

The main consequence of this evolution has been the consolidation, within the business sector, of a “dualistic” structure of interests in the setting of trade policy: offensive interests, corresponding essentially to the stances of the agribusiness sectors, and defensive interests, reflecting the competitive weakness of the manufacturing sectors. The “activism” of the offensive interests varies according to

many factors, as the prices of exported commodities, the barriers faced by exports, etc. In the last few years, the high prices of commodities and the strong Chinese demand and high international prices significantly mitigated the “activism” of such interests, leaving the trade policy arena free for the defensive interests.

- *The increase of the import coefficient of the economy, largely reflecting the industrial demand for intermediate and capital goods.* For many industrial sectors, the import of inputs and machinery has been integrated to the business strategies, which imposes limits to the use of tariffs and non-tariff barriers (e.g., antidumping) to provide “extra protection” to sectors affected by the import growth.

The difficulties to accommodate conflicting interests in the management of the import policy are noticeable in many dimensions: the setting of Brazil’s list of exceptions to Mercosur’s Common External Tariff, the administration of “*ex-tarifários*”, a temporary exemption to the tariff applied to specific products (and often associated to the setting of a quota) and the management of contingent protection instruments<sup>7</sup>. It is worth noticing that the intra-industrial conflicts relating to the use of such policy instruments are managed according to the logic of import-substitution, where imports are “dosed” according to the needs and demands of the domestic producers.

The two above mentioned factors are closely related – but are not limited to – the impacts of China’s rise as Brazil’s first trade partner on its imports and exports: China has been responsible for a good part of the increased demand for primary goods exported by Brazil, like iron ore and soybeans. At the same time, it turned out to be one of the most relevant competitors of Brazilian industrial products in the domestic and in international markets. Bilateral trade flows fits perfectly into the “North-South” pattern, as Brazil exports essentially primary goods and imports manufactured products, especially mechanical and electronic products.

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<sup>7</sup> CINDES (2014)

As far as economic sources of policy preferences are concerned, the trade policy arena has been dominated, in the last few years, by the interaction of these factors and by the interests that they mobilized. No big change in trade policy resulted from the combined impacts of these processes: the offensive interests put very limited pressure on the government to open export markets – as they concentrated in the Asian markets and benefited from the commodities’ prices boom – and the intra-industrial conflicts limited significant increases in border protection against (industrial) imports.

Therefore, it is not by chance that the increase in non-border protection, mainly through industrial policy measures, has become the preferred way to conciliate the objective of safeguarding the domestic producers with the restrictions imposed by intra-industrial conflicts to the use of measures geared at providing additional protection to specific products or sectors.

For sure, the government could have derived proposals of trade liberalization from the diagnosis pointing to the lack of competitiveness of the industry. Here, ideas played their role, as the economic ideology of the party in power (Partido dos Trabalhadores) largely overlaps with the import-substitution strategy of industrialization and the historically dominant paradigm of foreign economic policy. The evolution of Brazil’s foreign trade generated, among the partisans of this strategy – within and outside the government –, concerns about “deindustrialization”, “loss of density in the industry”, etc. which provided the rationale for the arsenal of measures adopted, in the last years, to discriminate in favor of the domestic producers.

Although the measures adopted by the government reasserted the hegemony of the import competing interests in the political economy of trade policy, the import substitution mindset has been challenged by concurrent ideas and proposals, even if in a generic and non-systematic way.

Criticism comes not only from academicians and think tanks, but also from high representatives of business associations, like IEDI, CNI and FIESP. In general, they address, in press interviews or articles, specific features of the trade policy (e.g., the absence of relevant trade agreements in Brazil's agenda, the relatively high protection guaranteed to intermediate goods by the Brazilian tariff, the costs of Brazil's membership in a stagnated Mercosur), blamed for their negative impacts on industry's competitiveness<sup>8</sup>.

It is worth noticing that, in most cases, the rationale for this criticism is explicitly provided by trends and evolutions affecting the world economy, as the dissemination of new production models according to the logic of global value chains, the ongoing negotiations of mega-regional trade agreements, etc. Brazil is perceived as growingly isolated and disconnected from the major trends affecting a changing international environment.

Except for some academicians and think tanks, criticism addressing Brazilian current trade and industrial policies does not lead to comprehensive proposals of trade liberalization as an engine of growth and industrial structural change. Nevertheless, these new voices and ideas cannot be simply discarded or ignored. At least, they can be understood as a symptom of the limits – as perceived by a fraction of the informed public opinion – of the import substitution strategy to deal with the challenges faced by the Brazilian industry.

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<sup>8</sup> A good example of business criticism towards protectionism and more broadly recent trade and industrial policies can be found in the interview of Pedro Passos, President of IEDI – a think tank that puts together some of the main Brazilian industrial companies – to O Estado de São Paulo (*A indústria enfrenta crise profunda*), on September 6, 2014.

## 4. Conclusions

Trade and industrial policies have shown a remarkable continuity in Brazil in the last decade, despite an episode of trade liberalization in the early 90s and some conjunctural swings which had more impacts on the use of instruments than on the mindset behind the policies.

In this field, the policy mantra has been import-substitution. Trade and industrial policy instruments have been mobilized according to the goal of continuously expanding the domestic industrial structure and filling in the input-output industrial matrix. Competing paradigms and ideas related to trade and industrial policies required to go beyond import-substitution and to foster productivity and innovation – as the “structural transformation paradigm” adopted by Asian countries<sup>9</sup> – were made no room in the Brazilian debates on such policies<sup>10</sup>.

Despite the swings in economic activity and in the industrial performance, the hegemonic paradigm of trade and industrial policy kept an almost completely unchallenged position.

The current industrial crises and the failure of the policy responses conceived to specifically address this issue have generated some questioning among private actors, which seldom seeks to relate the poor performance of the industry to protectionism and to the logic behind it.

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<sup>9</sup> If structural transformation is to be given a relevant place in the menu of trade and industrial policies, “the key question is how to replace traditional static comparative advantage with dynamic comparative advantage that transforms the domestic economy in ways that are viable and competitive when exposed to international competition” (Moran, 2015).

<sup>10</sup> To be sure, import-substitution promoted structural transformation in Brazil until the late 70s, when the strategy showed the first signals of exhaustion as an engine of economic growth. From the 80s on, the capacity of import-substitution to foster structural change, in the sense employed by Moran (2015) and by other authors (Mc Millan and Rodrik, 2011), stalled. But the Brazilian policy model in trade and industrial matters remained captured by the import-substitution logic.

The resilience of the trade policy paradigm is again being tested, but the most likely scenario points to its continuity, at least during the second term of Rousseff. This long history of policy continuity raises an interesting question, whose discussion is beyond the scope of this paper: which conditions – related to interests and ideas – would have to be put together to foster a major policy change in the field of trade (and industrial) policies? Is the liberalization episode of the 90s helpful to assess the likeliness of such a change in the future?

The liberalization episode of the early 90s occurred in a period combining a complex transition to democracy making room for an “anti-system” candidate, very high (and accelerating) inflation rates and a fiscal as well as regulatory crises that blocked the tools of trade and industrial policy tools. The combination of these extreme circumstances seems to have been needed to produce the liberalization episode. However, as shown in this paper, the final output of this episode was not the inauguration of an irreversible process of trade opening, but the negotiation of a new equilibrium, increasing (unequally according to sectors) the exposure of domestic producers to import competition, but respecting the essential features of the import substitution model.

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