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## **Antitrust and protectionism: Brazil's recent experience\***

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The defense of competition has only become a relevant object of public policy in Brazil after the passing of law N. 8884/94, which instituted the Brazilian Competition Defense System (SBDC) and granted powers to the Administration Council for Economic Defense (CADE) to act as an independent antitrust authority.

Not by chance, this law was edited on 11th June 1994, two weeks after the promulgation of law N. 8880/94, which launched the Real Plan. Both are part of the set of economic reforms implanted in the country during the 90s, which included the opening of the economy, the reestablishment of the domestic currency standard, the removal of widespread price controls, the privatization of state companies and the creation of regulatory agencies in infrastructure and public utilities sectors. In the environment in force until the end of the 1980s, where there was a closed economy, price controls and no domestic currency, the antitrust legislation was, inevitably, reduced to a legal formality, as it was well illustrated by the pathetic experience of the CADE between 1963 and 1992.

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Seeking to improve law N. 8884/94, president Lula forwarded to Congress, in 2005 a SBDC restructuring proposal to restructure the SBDC unifying three organs (CADE, SESAÉ and SDE), establishing the ex-ante analysis of the concentration acts, reducing the number of operations to be submitted to CADE and creating conditions for the formulation of team of employees specialized in antitrust norms. This project, which began to be elaborated by the Cardoso administration in 2000, was approved in the House of Representatives (Câmara dos Deputados) in December 2009 with the support of all parties and is at present being discussed in the Senate.

If approved, this reform will mark the beginning of a new stage in the SBDC's history, in which CADE will be enabled to face its main challenge, that of promoting the consistence between competition policy and other public policies. The complexity of this task is illustrated in the next sections.

### ***Automobile and intermediate goods industries' market power***

The automobile industry is an international oligopoly which has an exceptional ability to extract governmental benefits and influence the negotiation of trade agreements, as seen in a long list of events registered throughout the 20th century. The most notable events include the industrialization strategies in Brazil, Argentina and Mexico in the 50s and 60s; the US-Canada Pact in 1965; Latin American policies to promote exports in the 70s and 80s; the voluntary exports restriction agreement between the US and Japan in 1981; the recurring competition between state administrations for fiscal incentives, especially in the US, EU and Brazil; the automotive protocol in Mercosur, etc. Currently, except for Japan, where customs tariffs for vehicles and auto parts are nil, the only restrictions to imports are the security and environmental impact norms, and the auto producers continue receiving some sort of governmental support in every country where they operate.

From the antitrust point of view, the main distortion caused by the above benefits is the increase of the market power enjoyed by automakers, already benefited by natural protection from the entry barriers typical in this industry. Besides the fixed costs of the productive installations, the investments in R&D, the formation of a national distribution network, maintenance and technical assistance, a crucial obstacle a new vehicle manufacturer faces is that of building its reputation in an international oligopoly whose dynamism is centered in product differentiation. This means that the initial expenditure in institutional publicity and promotion of newly launched products will be significantly higher than those of older firms.

In Brazil, the current import tax for vehicles is set at 35%, which corresponds to an effective protection tax of 180%, the highest in the country. This level of protection allied to the above mentioned factors confers to factories an incontestable power to fix prices in the Brazilian market. This market power can be illustrated by the comparison between average prices of new vehicle in Brazil and US in June 2010, referring to eight different models. When the vehicles are not manufactured in Brazil (Audi, BMW and Mercedes-Benz) the increase in prices in relation to the US market varies between 109% and 211%. Amongst other vehicles, disparities range from 53% to 115%.

This data show that these companies' market power is much higher than most of the companies whose concentration acts suffered some kind of restriction imposed by CADE in the last years. The typical situation that tends to generate such restrictions is that in which the company resulting from a fusion would potentially have the ability to sustain a price increase from 5 to 15%, during a period of not less than two years. To avoid the exercise of this market power, CADE can determine the alienation of certain assets, or eventually, veto the operation. However, since the passing of law N. 8884/94, the auto producers in Brazil have been freely exceeding these parameters.

Like the automakers, intermediate goods manufacturers also receive a customs protection that is unjustifiable. Even though the import tariffs are at first sight moderate, ranging between 10% and 16%, the damages caused to the Brazilian economy are more serious, in the case of intermediate goods. As for automobiles, the loss of well being originating from protection is circumscribed to the revenue extracted from consumers and taken by automakers. However, in the case of intermediate goods, barriers burden the cost structures of the users of these goods and thus damage the efficiency levels of the entire industrial system.

Apart from this, there are at least three additional reasons that advise cautiousness in the application of tariffs on the importing of intermediate goods. The first is a result of the obstacles involved in the substitution of local input for similar imported input, which generates a natural protection for the manufacturers established in the country, making the customs tariff superfluous. When a firm uses a national provider regularly that meets its technological needs, it will only acquire inputs abroad in extreme situations. Apart from the exchange risk and logistic costs, the change in the supplier often implies changes in the company's production routine, periods of adaptation to the peculiarities of the imported good, possible changes in the quality of the final product and uncertainty in relation to the reaction of consumers to the product's new characteristics. This phenomenon explains to a large degree the stability of the import coefficients of intermediate goods in Brazil between 2000 and 2006. During this period, the increase in the value of the Brazilian currency was of approximately 40%, however, the producers of these goods managed to augment their positions in the domestic market.

The second reason for not protecting producers of intermediate goods is that, generally, they constitute monopolies or oligopolies, while the majority of their clients are non-concentrated industries. This difference

in the organization profiles of production, together with reduced elasticity in the substitution of national for imported inputs, confers great bargaining power to domestic producers of intermediate goods, which can be exacerbated with the support of customs protection.

Finally, the third reason is that the rhythm of technical progress in the production of intermediate goods was intense during the second half of the 20th century, partly due to innovations introduced by some multinational companies that currently operate in Brazil. Thus, the only role of the customs tariff in this case is to increase the market power already naturally provided by the technological leadership.

### ***Antidumping and anticompetitive conduct***

Apart from the customs protection granted to the main oligopolies established in Brazil, another market distortion created by the government arises from frequent antidumping measures that have been applied to intermediate goods imports. Between 1998 and 2009, around 80% of the 313 actions initiated by the Ministry of Development, Industry and Foreign Trade (MDIC) sought to protect the manufacturers of these goods. The adverse impacts of this kind of protection on the competition conditions prevailing in the domestic market are also known and well documented in the economics literature. However, these impacts have been ignored by MDIC, even in those cases that explicitly challenge antitrust laws.

The surpassing of the disparities between the actions of SBDC and the trade policy in place in the last two decades depends on two non-trivial changes. The first would be a reform of the Mercosur Common External Tariff (CET), seeking to abolish the customs protection that has been conceded to the main oligopolies that operate in the country. The second would be to introduce more restrictive criteria in the application of antidumping measures.