

**A BRIEF HISTORY OF TRADE POLICIES IN BRAZIL:
FROM ISI, EXPORT PROMOTION AND IMPORT LIBERALIZATION
TO MULTILATERAL AND REGIONAL AGREEMENTS***

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Paper prepared for the conference on
“The Political Economy of Trade Policy in the BRICS”
March 27-28, 2009
New Orleans, La

Abstract: This paper describes Brazilian trade policy from ISI (in the period beginning in the immediate post-War until late 1960s) to trade liberalization (from mid-1980s to mid-1990s). It also discusses policies introduced after 1964 to promote exports, such as subsidies and a crawling peg (abandoned in mid-1990s). After 2000, trade policy has focused on multilateral and regional negotiations, which are examined in the last section.

*Thanks to Paulo Gala for assistance.

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A BRIEF HISTORY OF TRADE POLICIES IN BRAZIL: FROM ISI, EXPORT PROMOTION AND IMPORT LIBERALIZATION TO MULTILATERAL AND REGIONAL AGREEMENTS

This paper examines the history of trade policies in Brazil since the 1950s. In the 1930s and 1940s, the Great Depression with its protectionist policies and World War II isolated the country from the rest of the globe and Import Substituting Industrialization (ISI) responded to the lack of external financing. The 1950s, not only in Brazil but also in Latin America in general, was transformed into the spitting image of voluntarism, which believed that an intervening State was better than the market. The ideology of the period revisited the theoretical model of imperialism and functioned around representations of the center and its periphery, portrayed in the theory of dependence (developed at the United Nations' Economic Commission for Latin America (ECLA) in Chile).

The growth of trade during the 1960s and 1970s opened the doors for the debates on agrarian and tax reforms. The Alliance for Progress and the Inter-American Development Bank participated in reforms during this period. With the availability of cheap credit from petrodollars in the 1970s, government and the private sector borrowed heavily generating high but unsustainable economic growth. When oil prices increased both in 1974 and in 1979 and interest rates rose in 1980, the high accumulated debts proved unsustainable, inducing a debt crisis. The result was almost 15 years of low growth and hyperinflation. The defeat of the heterodox programs for stabilization led to the Washington Consensus and praise for the Asian model. This takes us to the 1990s, which saw the beginning of the privatizations and trade liberalization.

Half a century of trade protectionist policies had resulted in Brazil having less than a 1 percent share in global trade, despite its population representing almost 3 percent of the world's population in 1990. The accumulation of problems from high levels of debt and inefficient state-owned industries induced Brazil to rethink its strategy to a more market-driven and trade oriented approach.

Between 1947 and 2008, the average trade balance was positive. Yet, trade surpluses (1.4 percent of GDP per year on average) were not enough to pay for financial and other services. Thus, during the same period, as a consequence of negative current accounts (-1.8 percent of GDP on average), the country has accumulated negative foreign assets. Instability has marked the post-War II period in Brazil during the last 61 years. Yet, in only two periods, trade balances were consistently negative: between 1971 and 1980 and again between 1995 and 2000, as shown in figure 1. In both periods,

plentiful foreign liquidity made it easy to finance growing current account deficits. Between 1971 and 1980, capital flows allowed the country to avoid adjustment to two oil shocks. Between 1995 and 1998, external liquidity allowed the use of the exchange rate anchor to stop inflation until the real collapsed in early 1999.

From 2003, exports and imports grew quickly. Three factors were important, starting with the preceding real devaluation (as the real exchange rate had devalued between 60 and 70 percent in 2002 relative to 1998). Then both international prosperity and the improvement of terms of trade worked in favor of Brazilian trade, since after 2004, real appreciation was more than counterbalanced by the increase in export prices. But since the end of 2008, global financial crisis and recessions (faced by the developed economies in addition to the significant slow down in China's growth) resulted in a rapid fall in trade. The failure of the Doha round, together with the trend in protectionism, has made the situation even more difficult.

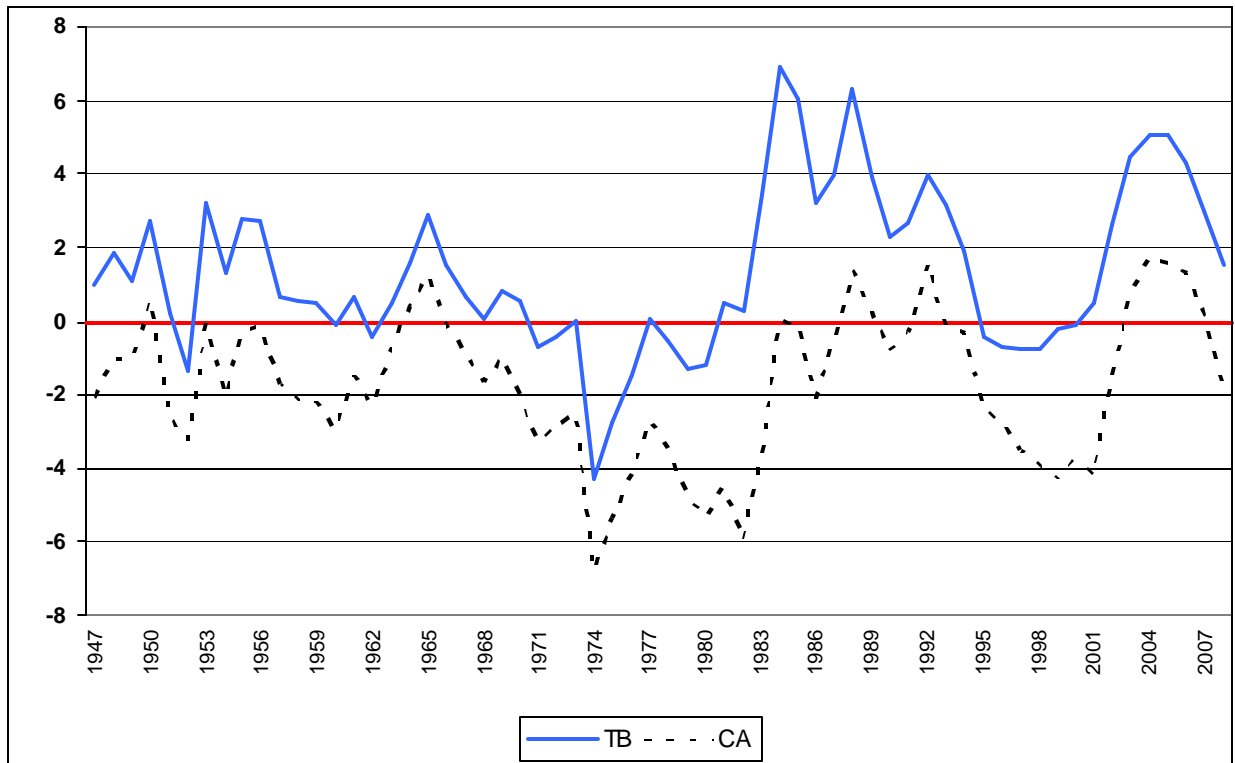
While China's role as a trading partner has been growing in recent years, the United States remains Brazil's main destination market, followed by Argentina, China, and the European Union. These same countries are its main import sources.

Since 1990, Brazil has improved international integration and opened markets via three routes:

- Unilateral liberalization (it substantially reduced tariff rates unilaterally, from an average of 51 percent to an average of 12 percent)
- Multilateral agreements (it participated in the Uruguay Round making substantial commitments to reduce import barriers and bind practically all tariff lines)
- And regional opening (it entered intra and extra-regional preferential trade agreements).

The next section discusses the passage from protection (since the immediate post-War II period until late 1960s) to a more open economy in the 1990s. Then the paper moves to a discussion of export subsidies and exchange rate policies. The final section examines trade agreements.

Figure 1
Share of the Trade Balance and of the Current Account in GDP
Brazil, 1947-2008
(Percent)



Source: Ipeadata, Instituto de Pesquisa Aplicada (IPEA).

2. FROM ISI TO IMPORT LIBERALIZATION

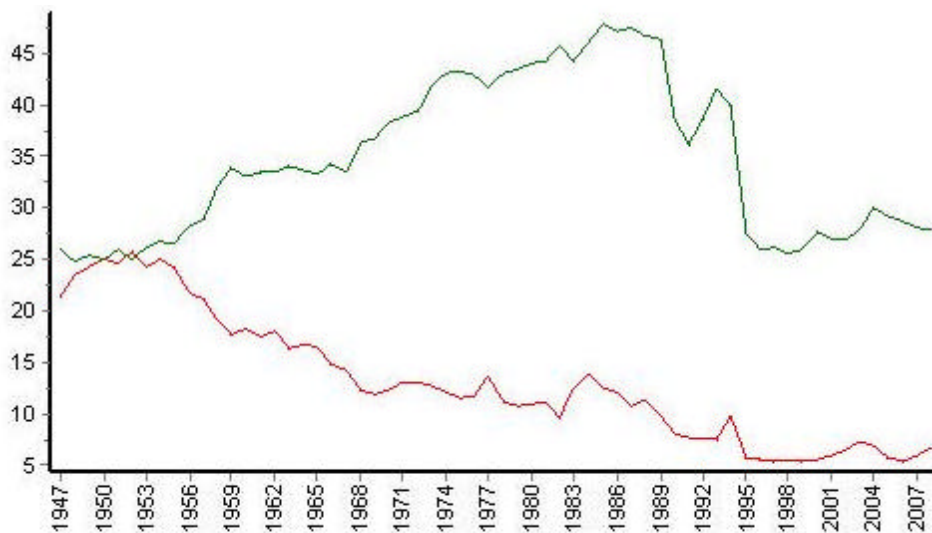
From the 1930s to the early 1960s import substituting industrialization (ISI) dominated economic strategy in Brazil. Although the country has long since undergone a reversal of the ideology associated with ISI, policies adopted in that period have had a profound impact. The main tools used to implement an ISI strategy were import licensing, tariffs, quotas, import prohibitions, overvalued exchange rates, and direct government investment in key industries.

These policies did stimulate industrialization in Brazil. Some industrialization would have occurred anyway, but the market shift of resources into industry contrasts sharply with the slow development of manufacturing before mid-1950s, as shown in figure 2.

Figure 2: Share in GDP of Value Added in the Agricultural Sector (in red) and of the Value Added in the Industrial Sector.

Brazil 1947 – 2007

(Percent)



Source: Instituto Brasileiro de Geografia e Estatística, Sistema de Contas Nacionais (IBGE/SCN 2000 Anual)

Brazil managed to establish a successful automobile industry and efficient steel production. Nonetheless, ISI induced economic and external imbalances were already apparent in the late 1950s. But until 1968 Brazil continued to pursue the state-led, inward-looking, ISI model. Public policies continued to promote the development of domestic manufacturing through high trade barriers, state-owned enterprises and subsidies. High trade barriers were erected for imports that competed with national production, while barriers were low for certain production inputs.

ISI and recurrent exchange rate crises resulted in a protectionist structure that only allowed those goods without domestic counterparts or needed to cover eventual over demand to enter the country. Discriminatory control favored some products with tariff reductions or exemptions. Table 1 illustrates the importance of non-tariff barriers during that period. Legal tariffs rate were considerable, but implemented average tariff rates, measured by the ratio of duties to total imports was below 6 percent in 1982. The explanation is straightforward: if imports were permitted at all, they were almost always exempt from tariffs or received large rate reductions.

Table 1
Nominal and actual tariff rates
Brazil, 1982
(Weighted averages, percentage)

	Nominal	Actual
Total imports, except fuels and wheat	47.5	13.7
Total imports	22.4	5.9

Source: Heloísa Correia e Aloísio Araújo. *Política Brasileira de Importações: Uma Descrição*. Rio: IPEA. 1984.

By late 1980s, Brazil's import policy exhibited the following basic characteristics:

- ✓ A tariff structure based on rates established in 1957, with only minor modifications.
- ✓ A generalized presence of tariffs with redundant quotas.
- ✓ The charging of various additional taxes, such as the IOF – Imposto sobre Operações de Crédito, Câmbio e Seguro [Financial Transactions Tax], TMP – Taxa de Melhoramento de Portos [Port Improvement Tax] and the AFRMM – Adicional de Frete para Renovação da Marinha Mercante [Additional Tax for Renewal of Maritime Transportation].
- ✓ Ample use of Non-Tariff Barriers (NTBs), such as a list of products with suspended import licenses, specific advance authorization for certain products (steel and IT products) and annual corporate import quotas. The generalized application of non-tariff restrictions made it especially difficult to indicate the sectors more favored by these instruments. The only information available was for the percentage of the number of products with suspended import licenses of the total number of products, by industry type. Based on this information, in 1987, the sectors most protected by barriers were: tobacco, real estate, plastic products, clothing, footwear and textile products, perfumes, soap and candles, and transport material.
- ✓ The existence of 42 special regimes, allowing for the exemption or reduction of taxes.

These policies allowed for growth of the country's diversified manufacturing output, but were insufficient to permit competitive integration into the international market. Thus, from 1988, the government began a new policy with the intention of inducing, through external competition, a more efficient allocation of resources.

Trade Liberalization

The import policy changes that took place followed a script that started with the updating of tariffs in order to eliminate the redundant share. Then, the elimination of special regimes followed and reduced the protection of certain favored sectors. Once this had been concluded, the NTBs were made extinct without significant impact on trade and incomes. Finally, in the last stage, when the prevailing protectionist structure was already clearly defined, customs tax was gradually reduced, stimulating productive efficiency.¹

Three tariff reduction programs were implemented in the periods: 1988-1989, 1991-1993 and in 1994. In the first phase, corresponding to the period 1988-1989, two tariff reforms were undertaken seeking to eliminate the redundant share of the nominal tariff without significantly impacting import volumes. NTBs were abolished in 1990, with imports being controlled through import tariffs. The special tax regimes followed the withdrawal of the NTBs, in the period 1991-1993, and were in turn substituted by a schedule of gradual import tariff reductions, which had been announced in advance. The third phase, during 1994, was associated with tariff reductions promoted at the beginning of the *Plano Real*, with the intention to discipline domestic prices through greater external competition.

Then a short recess in the trade liberalization program followed and lasted from 1995 to 1998. The financing of growing trade deficits – which resulted from the overvaluation of the exchange rate coinciding with the opening of trade – became unfeasible following the Mexican crisis of 1995. This period saw the raising of tariffs for a group of consumer goods. Administrative difficulties for imports were reintroduced for a few years, consisting of payment in full for external purchases, the definition of a list of products for which advance import licenses were required, and the application of safeguards.

Nominal tariffs

Table 2 presents average nominal tariffs.² Observe the accentuated downward trend of the weighted average nominal tariff, going from 55 percent in 1987, to 10 percent in 1994. However, a slight upward trajectory can be seen from 1995, when it increased to 12 percent, and again to 15 percent in 1997-1998 – a level similar to the one experienced in 1992. By 2004, the average tariff rate was down again at 12.2 percent.

The standard deviation, indicating greater uniformity in the tariff structure, declines from 21.3 percent in 1987, to 6.4 percent in 1998, with a small peak for 1995-1996. However, the nominal tariff structure did not undergo any great changes, for the correlation between the tariffs by sector in 1987 and 1989 is 72 percent.

From 1996, the tariffs only underwent punctual changes, leaving the average tariff constant. As a result of the ending of the international financial crisis, in November of 1997, the government temporarily raised the tariffs by three percentage points, increasing the average tariff to 15 percent. The tariff reforms undertaken during the period 1987-1998 failed to significantly affect the nominal tariff structure.

Table 2
Average, Standard Deviation, and Maximum and Minimum Value of Tariffs
Brazil, 1987- 1998
(Percent)

Year	Average	Average (Weighted by Value Added)	Standard Deviation	Maximum Value	Minimum Value
1987	57.5	54.9	21.3	102.7	15.6
1988	39.6	37.7	14.6	76.0	5.6
1989	32.1	29.4	15.8	75.0	1.9
1990	30.5	27.2	14.9	78.7	3.3
1991	23.6	20.9	12.7	58.7	1.7
1992	15.7	14.1	8.2	39.0	0.6
1993	13.5	12.5	6.7	34.0	0
1994	11.2	10.2	5.9	23.5	0
1995	12.8	10.8	7.4	41.0	0
1996	13.0	10.8	8.7	52.4	0
1997	15.6	13.4	7.6	47.1	0
1998	15.5	13.4	6.6	38.1	0

Source: Kume, Honório, Guida Piani e Carlos Frederico Bráz de Souza. "A política brasileira de importação no período 1987-1998." In Corseuil, Carlos e Honório Kume, coordenadores. *A Abertura Comercial Brasileira nos Anos 1990*. Rio de Janeiro: IPEA; Brasília: MTE, 2003.

Effective tariffs

An effective tariff rate takes into account the impact of tariffs applied to raw materials. It is a measure of the total effect of the entire tariff structure on the value added of output in each industry, when both intermediate and final goods are imported. Used to measure the real amount of protection afforded to a particular industry by import duties, its calculation assumes various simplifying hypotheses and, thus, results should be seen as indicative.

Between 1987 and 1989, the first two tariff reforms reduced the average effective tariff from 68 percent to 39 percent, and the standard deviation from 54 percent to 45 percent.

In 1987, the five sectors most favored by the tariff structure in force at the time were automobile, trucks and buses (with an effective tariff of 308 percent), textiles (123 percent), rubber (122 percent), vegetable product use (122 percent) and clothing (117 percent). The least protected activities were: oil and coal extraction (8 percent), diverse chemical products (12 percent), mining (17 percent) and steel (31 percent).

In 1989, after two tariff reductions, the highest effective tariffs were enjoyed by the automobile, trucks and buses (244 percent) and clothing (96 percent) sectors, whilst the lowest effective tariffs were those for oil and coal extraction (-5 percent), cattle farming (2 percent) and mining (5 percent).

The correlation coefficient (69 percent) of the effective tariffs by sector in 1987 and in 1989 shows that, in general, the effective protection structure remained largely unchanged.

With the tariff reductions promoted during the period 1991-1993, the average effective tariff went from 37 percent, in 1990, to 15 percent, in 1993, and the standard deviation decreased from 61 percent to 14 percent for the same period. This latter result reveals a greater degree of homogeneity in the domestic manufacturing incentives structure, whilst also indicating lesser interference by the government in the allocation of resources. However, the ranking of sectors according to the level of effective protection continued to be more or less identical.

Current Regime

Currently, Brazil's tariff regime is more protectionist than the average Latin America and the Caribbean (LAC) or upper middle income country, although less so than in the early 2000s (WTO, 2008). In 2007, Brazil ranked 92nd out of 125 according to the Trade Tariff Restrictiveness Index (TTRI).³ Its import weighted MFN tariff average of 8.7 percent is in line with averages for LAC or upper middle income countries. The maximum tariff rate of 35 percent

is comparatively very low. Its MFN applied simple tariff average of 12.2 percent, however, is above both the regional and the upper middle income group means.

Non-tariff measures (quotas and special safeguards) are used more extensively in Brazil than on average in LAC countries. It was used in 46.1 percent of its tariff lines in 2001 as opposed to 35.7 percent in LAC. Including non-tariff measures, Brazil's 2006 Overall Trade Restrictiveness Index (OTRI), which scores 20 percent, suggests a much more restrictive regime than LAC and upper middle income countries which score around 12 percent, both.⁴

The reduction of trade barriers appears to have played an important role in boosting productivity. Reduction in trade protection seems to have contributed to labor productivity gains. Schor (2004) suggests that the effect of easing tariff protection on productivity was strongest for low productivity firms. The productivity gain in the sectors producing electrical, electronic and mechanical equipment in the 1990s, for which the reduction in tariff protection was substantial, illustrates the link between trade openness and productivity advance. Cross-sectoral empirical evidence also points to boosted productivity from the increase in market penetration by foreign competitors as a result of trade liberalization and investment regimes.⁵

3. EXPORTS AND EXCHANGE RATES

For centuries, Brazilian exports reflected cycles of boom and bust of different commodities. Sugar exports from Brazil peaked in the 1650s. Competition from growing output in the Caribbean and lower prices reduced sugar prices. As a consequence, the Northeast lapsed into subsistence agriculture. In the 1690s, the discovery of gold and, in 1720s, diamonds in Minas Gerais, created new opportunities. The gold industry peaked around 1750, with gold production around 15 tons a year. As the best deposits were exhausted, exports declined. When gold production collapsed, Brazil turned back to agricultural exports. At independence, in 1822, the main three exports were cotton, sugar and coffee. At the end of the 19th century the country experienced a boom from rubber exports, to which the Manaus Opera House still testifies.

Brazil came to enjoy a monopoly in the market for coffee in the first half of the 20th century. During the 1920s, the government artificially maintained coffee prices by buying national production using external loans. The crash of 1929 dried up the sources of foreign financing and forced both the central government and the State of São Paulo to interrupt the scheme. Between

1928 and 1930, the price of coffee dropped almost 40 percent and caused the falls in export revenues and GDP. In 1931, the National Coffee Council began buying and destroying stocks.

It is estimated that Brazil's GDP fell 2 percent in 1930 and another 3 percent in 1931, but, in 1932 it was growing again and, in 1933 had already overtaken the figure for 1929. Despite the fact that the recession was serious, it only lasted two years. The price fixing policy for coffee, by guaranteeing the income levels of the plantation owners, allowed for the expansion of the manufacturing sector.⁶ However, the impact to the government budget was severe, with a suspension of the servicing of external debt between 1931 and 1932, followed by a readjustment plan in 1934, culminating in a default being declared by Getúlio Vargas, in 1937.

Since then coffee lost its importance. Currently, Brazil's main commodity exports are iron ores, soy beans, oils, and oilcake. But Brazil's exports today are highly diversified, as is reflected in a very low Export Concentration Index of 9.1 (OECD, 2008). This number is more typical of OECD countries.

From anti-export bias to export subsidies

The strong anti-export bias of ISI policies, in vogue until mid-1960s, derived in good measure from real exchange rate overvaluation. Foreign exchange controls introduced in 1947 were an important tool for the promotion of the industrial park. Throughout the period of 1947 until 1953, the domestic currency became increasingly overvalued. A system of licensing kept the demand for imports under control. The Export-Import Department of the Banco do Brasil (CEXIM) made foreign exchange available according to a five category system of priorities.

At the beginning of 1953 a new policy introduced more flexibility in the exchange rate system. Law 1807 created a limited free exchange market in which were allowed the inflow and outflow of capital and its earnings as well as buying and selling of foreign exchange for tourism. Instruction 48 of SUMOC (Superintendency of Money and Credit) divided exports into three categories according to which different shares of export revenues could be sold in the free market where the dollar was quoted well above the official rate. The earnings of traditional exports (coffee, cocoa and cotton) were to be exchanged at the official rate. Exceptions were made through a system of "minimum lists". Later in the year, Instruction 70 of SUMOC established a multiple exchange rate system, which eliminated direct quantitative controls and created an auction for obtaining foreign exchange.

In 1957, the exchange control system underwent further changes. Ad valorem tariffs were introduced rising to 150 percent. The exchange rate categories were reduced from five to two. Political

crises dominated the years from 1962 to 1964; the official rate lagged substantially behind inflation and, thus, created a disincentive to exports.

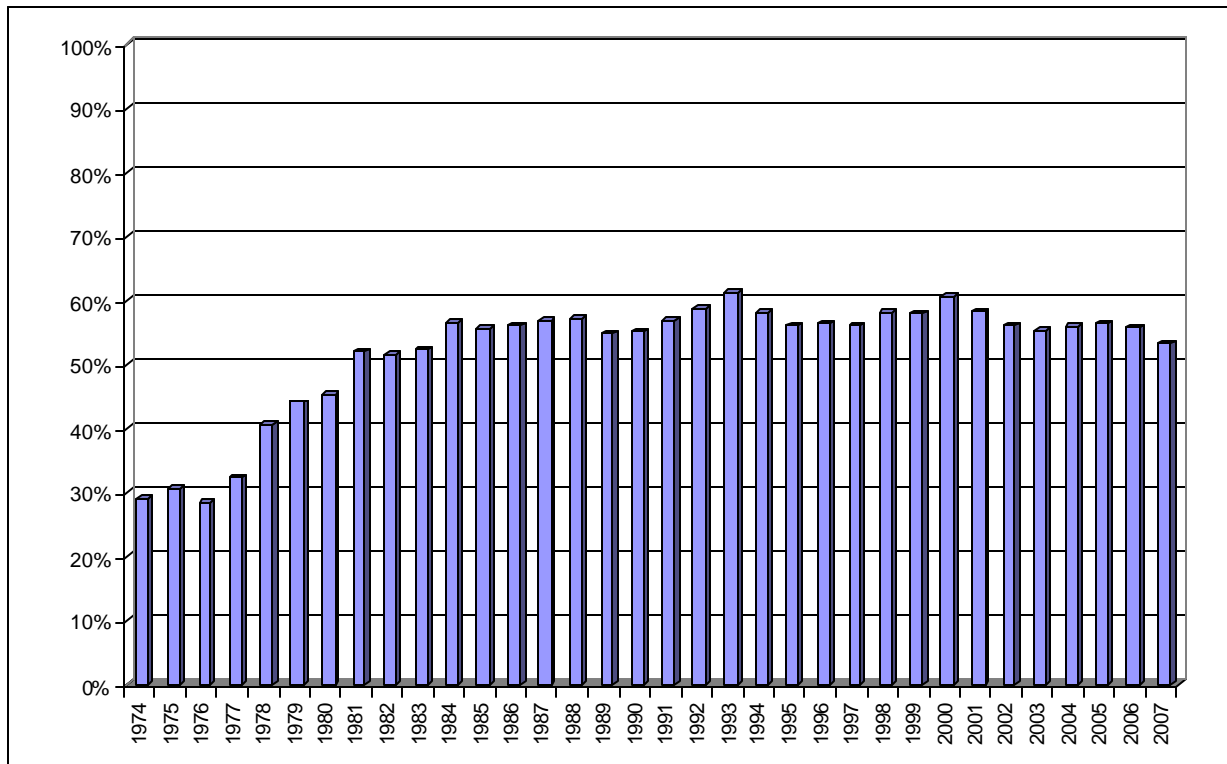
After 1964, the military government acted to increase the rate of growth and diversification of exports by undertaking a series of measures. It abolished state export taxes, simplified administrative procedures for exporters, and introduced a program of tax incentives and of subsidized credits for exporters.⁷

Fiscal subsidies for exports introduced after 1964 included:

- a. Exemption from tax on industrialized products (November 1964).
- b. Exemption of income tax on profits from exports (June 1965).
- c. Drawback of taxes on imported raw materials and components used in exported products (November 1966).
- d. Exemption of value added tax on export of manufactured exports (Constitution of 1967).

Changes introduced after 1964, such as a more stable real exchange rate than in previous periods and export subsidies may have contributed to export diversification. The share of manufactured exports in total exports increased from less than 30 percent in 1974 to more than 50 percent in 1981, as shown in figure 3. Since the 1980s, the share of manufactured exports in total exports has oscillated between 50 and 60 percent depending on how high the prices of commodities are.

Figure 3
Share of Manufactured Exports in Total Exports
Brazil, 1974 – 2007
(Percent)



Source: Funcex.

Whether export subsidies contributed to this change in composition and export growth is debatable. Panagariya (2000) asserts that arguments in favor of interventions on behalf of export interests are as flawed as the old arguments for import substitution. He shows that the argument that export subsidies may be useful for neutralizing import tariffs is spurious. In most practical situations, this is not possible and removal of tariffs is a far superior policy. He agrees that, in principle, a case can be made for protecting infant export industries in the presence of externalities. But the empirical relevance of externalities remains as illusory for export industries as it was for import-substituting industries. Subsidies will not yield the desired results in the absence of supporting policies, which include a generally liberal trade regime and stable real exchange rate.

Nogues (1990) finds that, despite export subsidies in virtually all Latin American countries, only Brazil during the 1970s and 1980s and Mexico during the 1980s achieved significant diversification of exports towards manufactures. The contrast between the two countries, however, is that Brazil made use of export subsidies, many of which were countervailed by the United States, whereas Mexico did not. Nogues therefore concludes that Mexico's strategy was less costly than the Brazilian one.

Although income tax fiscal incentives to exports have been eliminated, government credit – at interest rates below market rates to exporters through the Banco Nacional de Desenvolvimento Econômico e Social (BNDES) – continues to be a subject of debate at WTO.

Also controversial is the promotion of export processing zones. In order to qualify for beneficial treatment, the manufacturer must export 80 percent of their production. Provisional Executive Act 418 includes the following benefits to a manufacturer operating in an export processing zone: (1) suspension for 20 years of the obligation to pay import duties, federal value-added taxes (IPI), social contributions (Cofins), social integration program contributions (PIS/Pasep), merchant marine fund contributions (AFRMM) on imports and domestic purchases of goods and services; (2) elimination of the requirement that the qualified manufacturer obtain (and pay the required fees for obtaining) an import license or other federal agency authorization for imports and exports, except those related to sanitary controls, national security and environmental protection; (3) a full income tax exemption during the first five years and 75 percent reduction during the following five years. There are certain restrictions for foreign corporations.

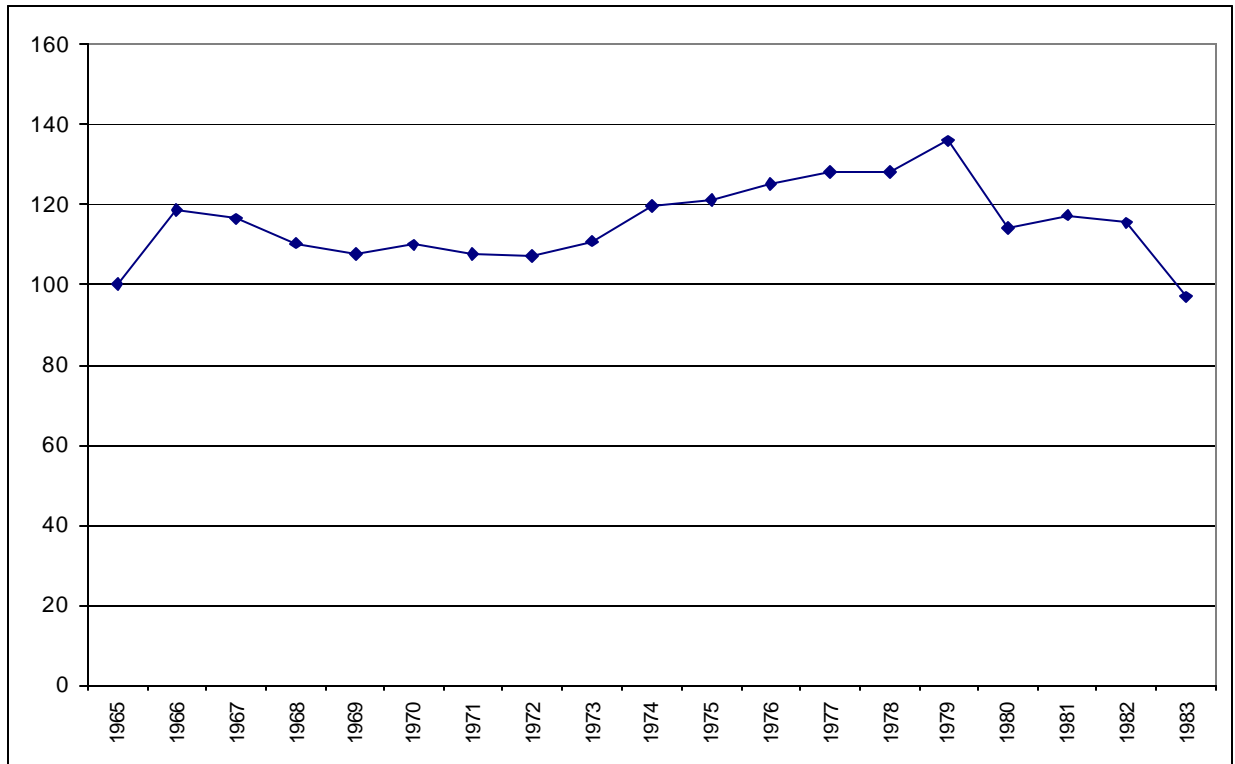
Exchange rates

Since 1964, the Brazilian exchange market has operated essentially unchanged in a formal legal sense. The market is operated by the Central Bank and by commercial banks authorized by it to conduct foreign exchange transactions. But the country has seen important changes in exchange rate regimes and policy.

In August 1968 Brazil adopted a crawling peg which effectively indexed the nominal exchange rate to the difference between Brazilian and foreign inflation. In principle, the crawling peg was an escape from overvaluation caused by higher inflation in Brazil than that in major trading partners. Before this policy was adopted there had been large but unintended variations in the real exchange rate as the nominal rate remained fixed for periods of as long as a year while domestic prices increased at double digit rates. The crawling peg was an advance relative to the past and the real exchange rate remained relatively stable between 1968 and 1982 (see figure 4). This is important because recent empirical evidence suggests that volatility in the exchange rate tends to affect productivity growth adversely in countries with thin financial markets according to Aghion (2006). The stable real exchange rate may have helped the Brazilian miracle of 1968-73.

But after the 1970s oil shock a more competitive exchange rate would have been advisable. Yet, the impact of the first oil shock is hardly discernible in figure 4, despite the adverse downturn in Brazil's terms of trade after 1974. The behavior of the exchange rate reflects the policy decision to finance the increased import costs through a sharp increase in capital inflows instead of allowing a real depreciation of the domestic currency.

**Figure 4: The “Minidevaluations” Regime
The Real Exchange Rate (Appreciation Up)
Brazil, 1965-1983
1965 = 100**



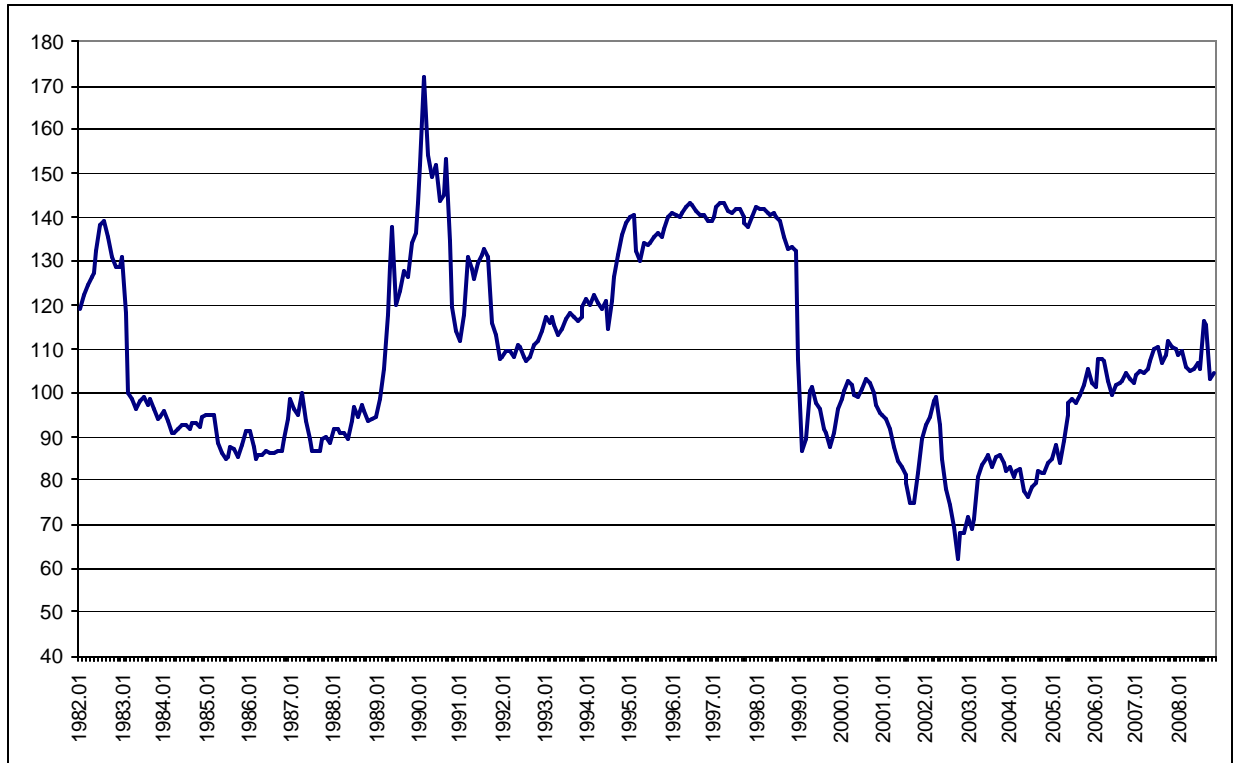
Note: Real Exchange Rate = Index of Brazilian CPI by FGV/ (Index of the Exchange Rate x Index of the U.S. CPI)

Source: Marcelo de Paiva Abreu, *A Ordem do Progresso*, Rio de Janeiro: Editora Campus, 1990.

In 1979 the government announced a step devaluation of 32 percent as part of a larger package that included the elimination of several export subsidies. The attempt to increase Brazilian competitiveness through the real exchange rate soon failed because inflation went up. In 1980, inflation jumped to more than 100 percent. By February 1983 a second major devaluation was necessary despite the continuation of the crawl. Inflation continued to rise and the Cruzado Plan of February 1986 marked the third major change in the exchange rate policy since 1979. As part of the general price freeze the nominal exchange rate was also fixed. As the Cruzado Plan unraveled, the real exchange rate once again began to appreciate. Figure 5 shows the extreme instability of the real exchange rate since 1983.

A ratchet pattern characterized the behavior of inflation in the late 1980s when a series of heterodox policy interventions resulted in lower inflation rates for a few months, after which inflation climbed upward again. This is reflected in the behavior of the real exchange rate in figure 5 until the Real Plan brought inflation under control in mid-1994. Inflation fell from four digits in 1994 to two digits in 1995 and to less than 2 percent in 1998. During those years the previous crawl was replaced by a managed band and despite success in bringing down inflation and minor devaluations between 1995 and 1998, there was strong real exchange rate appreciation. The domestic currency collapsed in early 1999 and Brazil moved to a flexible exchange rate regime, which is still in place.

Figure 5
Index of the Real Effective Exchange Rate (Appreciation up)
Brazil, 1982 – 2008



Note: Inverse of the effective exchange rate calculated by Ipea in Ipeadata.

Recent developments

Brazil's real growth in total trade of goods and services accelerated from a per year average of 6.8 percent in 2000–04 to 10.2 percent in 2005–06 and to 11.3 percent in 2007 (the regional mean in 2007 was 7.5 percent). In 2007, Brazil ranked 32nd out of 160 on trade outcome, according to the WTO.

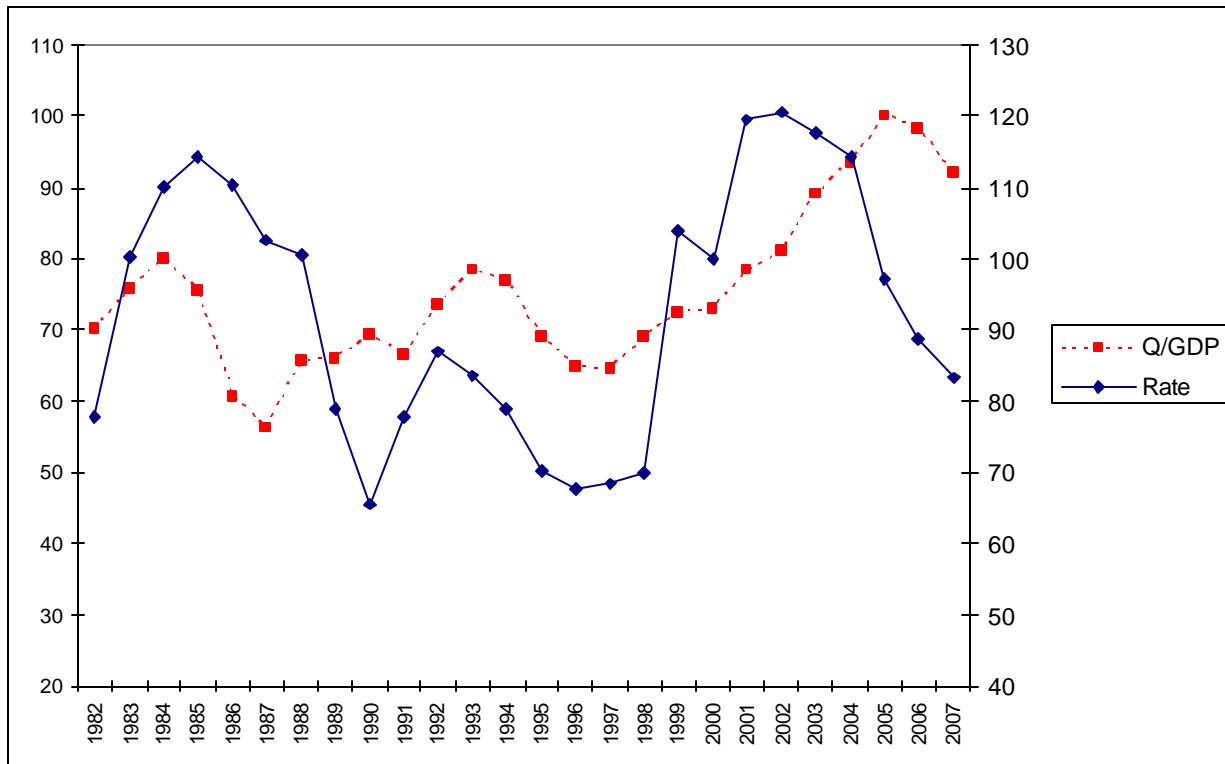
With a well developed domestic industrial sector, manufactures account for almost half of total exports. Figure 6 shows a strong correlation between the ratio of the quantum of manufactured goods in real GDP and the real effective exchange rate.

Other variables are, perhaps, even more important to explain the recent growth in total export revenues. They include the favorable international environment until mid-2008 that contributed to the increase in demand for Brazilian exports and the increase in Brazil's export prices.

Brazilian exports have been losing ground since the third quarter of 2008. Exports have been negatively affected by the combination of (i) lower prices (commodity prices, which declined 33 percent since their peak in mid-2008, eventually bringing down the prices of Brazilian exports); (ii) a sharp reduction of global demand, and (iii) a considerable slowdown of other Latin American economies, which absorb about 40 percent of Brazilian exports of manufactured goods.

The behavior of commodity prices (and their tight correlation with Brazilian export prices) suggests that the performance of Brazilian exports would be largely determined by commodity exports. A closer inspection reveals that the decline of Brazilian exports has resulted not only from the performance of commodities, but also from a considerable slowdown of manufactured exports.

Figure 6
Index of Quantum of Exports of Manufactures Divided by Real GDP, 2006 =100,
And
Index of the Effective Real Exchange Rate, 2000 = 100 (Depreciation up)
Brazil, 1982 - 2007



Note: The real effective exchange rate is the weighted average of purchasing power parity of the 16 major trade partners of Brazil. Purchasing power parity is defined as the ratio of the country's wholesale price times the nominal exchange rate (R\$/unity of foreign currency) divided by Brazil's Consumers Price (INPC/IBGE).

Source: Ipeadata, Instituto de Pesquisa Econômica Aplicada (IPEA).

Two important impediments to export expansion are the country's cumbersome business environment and market access.

Brazil's overall Doing Business 2006 rank (122nd out of 178, down from 113th in 2006) reflects the difficulties of starting a business, closing a business, and enforcing contracts. Its governance indicators were also worse in 2006 than in the late 1990s or early 2000s. On the other hand, Brazil's Logistics Performance Index score of 61 (out of 151), surpassed the regional and upper middle income group averages.⁸ Here, Brazil's weakest indicator was efficiency of customs and other border procedures, while its strongest logistics indicator was timeliness of shipment.

Brazil ranked 63rd out of 125 in the 2007 Market Access TTRI (including preferential tariffs).⁹ Brazil's agricultural exports face considerably higher tariff barriers (12.8) than those from an average LAC (6.2) or upper middle income country (8.1). But it faces tariff rates on its manufactured exports are, on the whole, fairly low (1.7 percent). MFN duty-free exports constituted about 37.9 percent of Brazil's total exports in 2006, a share above the regional and upper middle income group means.

4. TRADE AGREEMENTS

Multilateral and regional negotiations are an integral part of Brazil's trade policy. The main negotiations in which Brazil has been involved over the last 10 years, and will be involved in during the next 10, are the World Trade Organization (WTO), Free Trade Area of the Americas (FTAA) and the Mercosur expansion.

WTO

A Doha meeting between ministers in Qatar, in 2001, gave rise to a new WTO round and defined a work program that was intended to have been concluded by the beginning of 2005. The meeting reflected a commitment that was very favorable for Brazilian interests, whilst a parallel agreement allowed for the conciliation of interests relating to public health with the preexisting rules for intellectual property. Thus, the costs associated with the implementation of legislation regarding the TRIPs for developing countries, approved in the Uruguay Round, were reduced.

At Doha, Brazil did not raise objections as radical as other developing countries, such as India, regarding the incorporation of new rules about the "Singapore terms" (competition policy, governmental purchasing transparency and facilitating trade). As for the environment, the meeting saw a softening of the most extreme proposal, originating from the European Union.

On less defensive terrain, Brazilian interests were concentrated on two subjects: agricultural protectionism, especially the decommissioning of export subsidies, and anti-dumping legislation. As a member of the Cairns coalition, which unites countries in favor of the decommissioning of agricultural protectionism, Brazil pressed for the inclusion of an explicit mention for the elimination of export subsidies for agricultural products. Furthermore, it pressed for an improvement in market access and a substantial reduction in the support for domestic production that provokes distortions in the trade of agricultural products.

At the following round, in 2003 (Cancun, Mexico), Robert Zoellick, the US trade representative, tried to save the Doha Round with an innovative proposal – the abolition of all import tariffs for industrial goods between the 144 WTO member countries, to last until 2015. By 2010, the idea would be to have eliminated all tariffs lower than 5 percent and set all the remaining ones at a rate of 8 percent prior to removing them entirely at a second stage.

So, what was the incentive offered to developing countries? The average tariff for textiles in the US, which was 20 percent, would be reduced to 8 percent, together with the quotas, which would be eliminated in 2005.

The emerging countries rebelled. Tariffs on industrialized goods in advanced countries were already, on average, below 5 percent, whilst agricultural tariffs and subsidies continued to be very high. For them, the most important point was the removal of tax burdens on their products through subsidies to the agricultural sector in the US and Europe.

But, the negotiation of agricultural subsidies was a very touchy subject in the US, whilst the EU lacked even a draft proposal for decreasing their levels of agricultural protection.

The developing countries were also concerned with the transition costs for their industries under Zoellick's proposal for the elimination of industrial tariffs. They knew that the tariffs were not the only trade barrier to overcome. Eliminating tariffs would be more attractive if accompanied by a genuine guarantee of access to the industrialized countries' markets.

For economists, the attractive aspect of the North American proposal was the multilateral negotiation among the 144 WTO member countries, which would relegate the dozens of bilateral agreements that work against a real opening, to second place. However, the negotiations failed – as they did in the subsequent meetings in Hong Kong (2005).

The negotiations have been crawling along ever since, with meetings around the world and deadlines constantly being missed in Geneva, Switzerland (2004, 2006, 2008); Paris, France (2005);

and Potsdam, Germany (2007). The most recent round of negotiations in 2008 broke down after failing to reach a compromise on agricultural import rules. After the breakdown, major negotiations are not expected to resume until 2009.

The history of the GATT and the WTO reveal that case by case negotiations (based on the exchange of specific concessions defined in the light of offers that do not include the universe of products) prevail over an all inclusive treatment for the trade barriers between countries. Thus, multilateral negotiations have always postponed a reduction in the levels of protection for so-called “sensitive” products. The consequence is a backlog of products that remain at the edges of multilateral liberalization, such as agricultural and textile products. Based on history, it is difficult to avoid being skeptical and believe that the new WTO Doha round will mark a great change from the past.

FTAA

In the 1990s, the success of the European integration motivated plans and projects to unite the economies of the Americas into a single free trade area. In December of 1994, the Summit of the Americas, held in Miami, united the Heads of States and Governments from the 34 democracies in the region, who decided to create the Free Trade Area of the Americas (FTAA).

The contrast between the formation of the European Union and the FTAA could not be greater. The EU started as a customs zone and with the firm intention of heading towards a common market and currency and political integration under supranational institutions. The start of the EU as a customs zone also coincided with a period of strengthening of the GATT.

The FTAA, on the other hand, started during a period of fragility of the WTO. And, as opposed to the EU, it was born as a sum of bilateral agreements between the US and Latin American countries, with no ambition of external harmonization, but with original rules that promised to be not only a can of worms, but one containing a tangle of worms of varying sizes. Furthermore, the US refused to entertain the idea of a single currency that would imply in giving seats on the Fed to representatives of Latin American countries. Nor would it consider a process of macroeconomic coordination or political integration under supranational institutions with effective power. On the contrary, since the beginning of the 21st Century, the US has threatened to reinforce the struggle for the achievement of bilateral agreements.

Since 2003, the FTAA stage of negotiations to eliminate barriers to trade and investment came to be driven by the co-Presidency of Brazil and the US. It would not be too surprising if the Brazil and the US Congress constitute two obstacles to progress in the agreement.

On Brazil's side, the plan to negotiate the FTAA in unison with South America has gone back to square one. Chile led the block and, without the leadership of South America, Brazil lost its bargaining power and the US sealed bilateral agreements, for example with Chile, Peru and Colombia.

The history of the US position as regards regional agreements is a long one. In 1982, the then US President, Ronald Reagan, disappointed with the European resistance to his proposal of a new multilateral trade liberalization round, went back on the position held by the US against regional agreements. From then on, the US was open to regional and bilateral agreements with any country willing to negotiate free trade. But, the FTAA discussion was shelved in 1995, when Senator Bob Dole argued that the country first needed to digest the NAFTA.

Excluding Mexico, the rest of Latin America absorbs less than 10 percent of North American exports – which is why North American businesses fail to see integration with Latin America as a great source of opportunities and why they lack interest in the FTAA. However, they should realize that Brazil could be the support for any US initiative in South America – an indispensable partner not only for opening markets, but also in the war against drugs. Brazil has common borders with nine of the eleven countries in South America and these borders make it a central player in any international effort against drug trafficking.

Working against a solid understanding between the two countries is the perception among Brazilians of an ambiguous US policy towards Brazil. This perception is a result of events that include the controversial support given by the United States in the 1964 military coup and the antidumping measures taken against Brazilian footwear, orange juice and steel. It is also enhanced by some erroneous ideas such as the one that the FTAA will only benefit the US and that they will place Brazilian sovereignty of the Amazon in jeopardy. To cap it off, there is also a certain jealousy guarded by small countries in Latin America, who feel insecure about a renewed dialogue between the US and Brazil. With so many difficulties, it is no surprise that the FTAA seems to have been relegated to the history books.

MERCOSUR

The process of approximation between Argentina, Brazil, Paraguay and Uruguay that resulted in the formalization of Mercosur 18 years ago, has a long history of advances and setbacks caused by diverse political agendas, economic asymmetries and the differing characters of each of these countries as regards external trade partnerships.

Argentina's and Brazil's re-democratization in the 1980s and the Second Montevideo Treaty (which created ALADI [the Latin American Integration Association]) brought the two countries together. Presidents Raul Alfonsín (Argentina) and José Sarney (Brazil) signed the integration Treaty in 1988. The political decision in favor of the quadrilateral format in the initial years of the Carlos Menén and Fernando Collor de Mello governments resulted, in 1990, in the Buenos Aires Act and, a year later, in the Treaty of Asunción.

Among the external factors that acted in favor of the formation of Mercosur, the following are worth noting: challenges created by the beginning of the free trade agreement between Canada and the US, in 1989, and the perspective of its expansion to other countries in the Hemisphere; the Single European Act of 1986; and the non-conclusion of the Uruguay Round, in December of 1990.

The initial discussions involved Chile and Uruguay, although Paraguay had still not been included. Chile decided not to take part in the common market project. The tariff proposals went against its profile of a single, horizontal and exclusive 11 percent tariff at a time when Brazil and Argentina still had average import tariffs of more than 40 percent, with peaks occasionally reaching above 100 percent. Once Paraguay had rehabilitated itself from a dictatorial past (at least, provisionally), it was incorporated into the negotiating scheme because Brazil considered its entry into the block as a means of regulating the illegal trade over the border between the two countries.

The Treaty of Asunción of 1991, which formally created Mercosur, preserved political reciprocity and equal rights and obligations among the member countries, despite the differences between them. The treaty proposed the constitution of a future common market and established ambitious deadlines for the harmonization of sector policies and the coordination of macroeconomic policies.

Mercosur's development went through different phases. The transitional phase foreseen in the treaty was set to last until the end of 1994. It was followed by a phase of the institutional configuration of the customs union, begun in 1995 and regional trade grew until 1998. This was then followed by a period of many conflicts and, finally, the acceleration of trade from 2003 onwards, until the middle of 2008.

Intra-Mercosur trade, in its initial golden period, increased from 4 billion dollars in 1990 to 20 billion by 1998. But, in 2000, it fell to 18 billion. There was a confluence of an open political and economic crisis, with a devaluation of the Brazilian Real in January of 1999 and the threat of "Dollarization" in Argentina. The fluctuation of the Real exacerbated macroeconomic divergence

among the Mercosur countries and interrupted the institutional progress of the customs zone. Trade disputes multiplied. Mercosur's agreements with the rest of the world progressed no further. Brazil and Argentina disagreed about which position to take regarding the United States, with Brazil showing disinterest in the FTAA.

In 2002, the IMF abandoned Argentina, and the country's pleas for help to Brazil fell on deaf ears. Discordance regarding common external tariffs grew and Argentina's President Nestor Kichner wanted to create a safeguard mechanism that allowed for the imposition of trade barriers should a member country feel that local industry was being put at risk. The chances of integration seemed ever more distant.

In the first half of 2003, the share of Brazilian exports in Argentina's imports climbed to 33 percent and the partnership did not like it. In July, serious symptoms of disagreement between the two countries became apparent. Cries for protectionism were heard more and more frequently in Argentina. On July 6th, 2004, the eve before the Puerto Iguazu Summit meeting, Argentina announced barriers to cookers, refrigerators and washing machine imports originating from Brazil and subsequently proposed the adoption of asymmetries in the automobile trade.

The Brazilian press pulled no punches in its criticism of the Brazilian authorities' reaction to the Argentine government's refusal to keep their old promises. According to the *Estado de S Paulo*, the new Itamaraty was limp, passive and complacent. The reason for this weakness lay in the defense of an alliance that only served as an illusion of a third world geopolitical project. The criticisms ignored hundreds of intertwined interests in a trade flow greater than US\$ 12 billion.

But, in addition to the protectionist tendency that periodically devastates the region; the problems for integration were in large part derived from the two countries' cyclothymic character. International opinion believes that the two are so entwined that economic policy mistakes made by one end up being reflected in the economy of the other. More than a hundred years ago, The Economist magazine (01/10/1891) wrote about our inflationary policies of the end of the 19th Century: "The results of these policies became clear in Argentina's case. The time has come for whoever has an interest in Brazil to take note of the direction in which the country is sliding".

In the 1980s and 1990s, financial analysts continued to find a comparison between the two economies and their similarities simply irresistible. Autocratic and democratic governments presided over absurd rates of inflation. Populist and neo-liberal administrations regaled themselves in fiscal indiscipline and the growth of the State. In both countries, cycles of exchange rate overvaluation gave

way to fleeing capital and external crises. In both, the cycles of debt were bound to the precarious natures of contracts.

Since 2003, trade within Mercosur improved in relation to previous years. A variety of factors contributed to a less tense atmosphere and fewer pressures of trade conflicts: high economic growth rates of its member nations, expansion of investments by Brazil in the region and the appreciation of the Real against the Dollar, mirrored in the Real/Peso parity. These factors favored the growth of regional trade as a whole, as well as Brazilian imports by the block. Thus, until June, 2008, trade growth within the block reduced the conflicts despite the structural asymmetry in which the largest member presented a robust trade surplus against the other three member nations.

Brazil represents between 70-80 percent of the territory, the population, the GDP and the foreign trade of the four countries and is seen as the major beneficiary of the agreement. Since 2003, Brazilian exports to its Mercosur neighbors have been growing at a faster rate than its imports from these same countries. The subsequent growth of Brazil's trade surplus with each of its Mercosur partners is seen as a summary index of the economic asymmetries present in the scope of the block. In Argentina, the concern is related to the potential risk that the growing penetration of Brazilian industrial products in the national market represents to the boosting strategy for its manufacturing sector. In the cases of Paraguay and Uruguay, the deficits in relation to Brazil constitute proof that Mercosur brings little or no benefits to these countries.

The strong acceleration of total imports to Brazil in 2007 and the first half of 2008 reduced the country's trade surplus, but not in relation to its Mercosur partners. This, together with the devaluation of the Real against the Dollar as a result of the global financial crisis and its effects on the parity between Mercosur currencies, allow the forecast that sector conflicts between the partners will tend to worsen.

Mercosur remains an incomplete free trade zone. A significant part of the trade comprising products from the automobile sector is still under a special regime. As for the Common External Tariff (CET), it suffers from the imposition of temporary regimes of exception with national lists of exception defined by each of its members. The CET is the object of constant revisions with each new crisis. Another problem is the double charging of import tariffs. The single tax would mean that a product imported from outside the block would only pay the CET at the country of entry, then enjoying free transit through all Mercosur members. Today, the tariff is charged every time the product is re-exported to another country within the block.

Despite the political will of the four member countries, business cycles, different exchange systems and electoral processes impose perennial difficulties to the negotiations.

The external Mercosur schedule has presented scant progress, despite the various negotiation fronts that were opened by the block over the last few years. In addition to an international atmosphere that is becoming ever more unfavorable to trade liberalization movements, the block is mired with increasing difficulties of convergence of interests among its members as regards international integration projects. In 2008, Uruguay continued to plead for authorization to progress with bilateral negotiations independent of Mercosur, Argentina was unwilling to engage in new trade liberation movements and Brazil concentrated its efforts in obtaining results at the Doha Round, garnering criticism from some business segments.

Despite the various initiatives in progress, the signing of a free trade agreement with Israel, in 2007, was the only progress recorded. Negotiations for an agreement of fixed preferences between Mercosur and the South African Customs Unions ended – without the agreement being signed. The future of the WTO Doha Round – the top priority of the block's trade schedule in recent years – continues uncertain.

The remaining regional or bilateral negotiation fronts – with the EU, the Cooperation Council for the Arab States of the Gulf, India, Morocco, Egypt, Pakistan or Mexico – registered no progress. In addition to these, two new negotiation fronts for free trade agreements were opened as the result of the last Mercosur Summit: one with Jordan and the other with Turkey.

In the South American region, the constitution of the Union of South American Nations (UNASUL) in May of 2008 was announced by the governments as an important step in the regional integration project. The UNASUL Constitutive Treaty is very ambitious in terms of thematic schedule, but vague as regards trade and economic integration. In the scope of ALADI, discussions for the creation of a Free Trade Area are met by resistance of various orders from the majority of its members

Faced with the international context and the evolution of domestic macroeconomic outlooks, the Mercosur countries have been adopting diverging trade policy strategies. These differences, which were already arising in the reiterated requests from Uruguay to negotiate separate bilateral agreements with countries outside the block, also became very apparent in the WTO Mini-Ministerial Meeting held in Geneva, in July, 2008, when Brazil and Argentina took conflicting positions.

The deepening integration in South America faces difficulties coming from diverging trends in the economic models and international insertion strategies of the region's countries. The collapse of the Doha Round negotiations, a central subject of the block's agenda, raises further questions regarding the need for progress in regional or bilateral agreements. However, Mercosur is presenting difficulties in navigating the world of bilateral agreements.

Protectionist pressures in world trade tend to increase with the failure of WTO understandings. One of the protectionist trends that has already manifested itself in international trade is the introduction of technical and sanitary standards and regulations for products and manufacturing processes. These trends appear to be linked to the trade in agricultural and agroindustrial products, especially those relating to environmental issues. These measures have relevant impacts on Mercosur's trade interests, which are strongly focused on products made from natural resources.

Integration would assist progress with supranational institutions, which would have functions that used to belong to the sovereign governments of each country, as in the European process of integration. However, in the case of Mercosur, the disproportional power wielded by Brazil within the block makes the installation of these institutions difficult. Furthermore, Brazil and Argentina distrust supranational institutions. As there is no organized support from civil society in favor of the integration, or a supranational structure in place to protect the integration during lean times, any threat is capable of making Mercosur go in reverse. An international shock would soon serve as motivation for one of the countries to threaten to abandon its commitments.

Brazil sees Mercosur as a strategic platform to increase its international stature. The long term political-economic project would be a way of making the country more attractive to direct investment, a way of not being left out of the international political process and a way of increasing its bargaining power in negotiations with the US and the EU. Argentina, on the other hand, is concerned with short term crises. Without common goals, Mercosur is destined to go nowhere.

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¹ In describing trade liberalization in Brazil, this paper follows Kume, Piani e Souza (2003).

² For tariffs on products grouped by activity sectors, according to the IBGE [Brazilian Institute of Geography and Statistics] for the period 1987-1998, see Kume, Piani e Souza (2003).

³ TTRI (MFN applied tariff, all goods) is an index that summarizes the impact of each country's non-discriminatory trade policies on its aggregate imports. It is the uniform equivalent tariff that would maintain the country's aggregate import volume at its current level.

⁴ In recent years, however, the country has continued to liberalize its services sector. Particularly noticeable is the liberalization undergone in the telecommunications, financial services, and port and airport services.

⁵ See, for instance, Pinheiro, Gill, Servén and Thomas (2001) and Rossi and Ferreira (1999).

⁶ See Cardoso (1981).

⁷ See Tyler (1976) and Baumann and Braga (1988).

⁸ LPI - Overall - The Logistics Performance Index (LPI) reflects the overall perception of a country's logistics based on over 1,000 responses to a survey of logistics performance evaluated in seven key subcategories.

⁹ The MA-TTRI (applied tariff including preferential rates, all goods, is an index that summarizes the impact of other countries' trade policies on each country's exports, including preferential rates. It is a uniform equivalent tariff that would maintain a country's aggregate exports.