RICE UNIVERSITY'S
BAKER INSTITUTE
FOR PUBLIC POLICY

ISSUE BRIEF 08.27.15

Brazil's Trade Negotiations Agenda: Moving Away from Protectionism?

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In recent months, the media and trade analysts have perceived a discreet shift in Brazil's trade negotiations agenda under President Dilma Rousseff. Brazil decided to engage in wider negotiations with Mexico, while cautiously avoiding mention of a "free trade agreement" as the ultimate goal of the talks. At the same time, Rousseff appeared more assertive in relation to Brazil's interest in concluding the endless Mercosur[1]–EU trade negotiations.

How should we interpret this shift? Is Brazil moving away from its protectionist stance, which is deeply held by the main stakeholders of the country's trade and industrial policies? Is trade liberalization being included in the Brazilian economic policy menu in contrast with the protectionist tradition?

Brazil's history of the last 50 or 60 years would suggest a very cautious approach when analyzing this recent shift in the trade negotiations area. The protectionist tradition in Brazil's trade and industrial policies is far from fading and still occupies the driver's seat when it comes to these policies.

IMPORT SUBSTITUTION: A LONG-LASTING POLICY PARADIGM

Indeed, an analysis of the political economy of trade and industrial policies in Brazil since at least the 1960s highlights the continuity of these policies.

This continuity does not mean that Brazil's trade and industrial policies have remained unchanged over the last 50 years. In the early 1990s, Brazil underwent a unilateral trade liberalization, which was the main shift in the country's trade and industrial policies since the adoption of the import substitution model as an industrialization strategy.

However, Brazil's unilateral trade liberalization period led to a structure of protection in which higher tariff rates protected the same sectors favored by earlier trade and industrial policies under the import substitution strategy: automobile, electro-electronic, textile, and apparel, etc.

Continuity in trade policy went far beyond the specific features of tariff reform. In the immediate aftermath of unilateral liberalization, new incentive regimes were created to benefit these industrial sectors.

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 continued to be supported by an extensive coalition of bureaucrats and business associations from the industrial sector. These stakeholders played a central role in crafting national positions in international trade and investment negotiations—be it under Presidents Cardoso, Lula, or Rousseff. The main consequence of this hegemony is that, even though Brazil has become engaged

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in several trade negotiation initiatives, the country has systematically adopted protectionist positions—except in agriculture.

In the 20 years since the unilateral liberalization episode—from 1994 to 2014—trade and industrial policy objectives and instruments deriving from the import substitution model remained dominant; however, the combination of policy tools and the intensity of protectionism varied over time.

THE ORIGINS OF CONTINUITY IN TRADE POLICIES: INTERESTS AND IDEAS

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

In Brazil's case, 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.

The first one refers to the weight of non-economic sources of preferences or ideas in shaping public policies. The set of ideas supporting the resilience of the import substitution paradigm rests on two pillars:

- On 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. This view was crafted during the import substitution period and widely shared by politicians, academics, business, and trade unions.
- On 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.

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 driving the alliances and coalitions that the country sought in that 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. An additional policy goal was the consolidation of a diversified industrial structure. Both conditions were 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 cannot 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 relate 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.

The second domestic factor that accounts for the continuity observed in Brazil's trade and industrial policies points to the "economic interests'" dimension of the political economy of liberalization and reforms.[2] 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, from the liberalization episode of the 1990s until today. This liberalization occurred despite growing evidence that the industrial sector lacks competitiveness and is gradually losing relevance in the Brazilian economy.

THE SWINGS OF PROTECTIONISM IN THE 21ST CENTURY

Continuity in policy does not equate with immobility. In the first years of the new century, fewer protectionist 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 export sector with geographically diversified economic interests, which strongly benefitted from the emergence of China and its huge demand for commodities.

However, this trend did not survive the international financial crisis that began in 2008. What followed, during Rousseff's first term, was the "restoration" of a full-fledged protectionism in trade and industrial policies. This only confirmed the resilience of the set of ideas and interests inherited from the import substitution period.

The shift toward a more protectionist stance in trade policy began to show up in the beginning of 2010, following a sharp increase in Brazilian industrial imports—42 percent over 2009—and the sharp reduction in the share of manufactured goods in Brazil's exports, from 55 percent in 2003 to 39 percent in 2010. The government has become more and more sensitive to pressure from import-competing sectors and has introduced many protectionist measures explicitly aimed at defending domestic industry.

Although Brazil has become, in the last few years, the "world champion" in the use of anti-dumping measures, the return of protectionism under Rousseff was implemented principally through industrial policy measures inspired by import substitution.

Intersectoral discrimination in the allocation of investment and production incentives and subsidies was another major feature of Rousseff's industrial policies. The auto sector benefitted from a new investment regime, capital goods sectors received subsidized lines of public credit through BNDES,[3] and capital-intensive intermediary goods sectors received additional protection from imports through anti-dumping actions and temporary increases in tariffs.

The intensification of the requirements of local content in different policy tools seems to be one of the main features of the industrial policies adopted under Rousseff. It not only affected trade policy, but also the FDI regime as the incentives for investment (both domestic and foreign) have been drafted in a way to make their application contingent on (high) levels of national content and technology intensity. Several of these incentives are being challenged by the European Union and, more recently, by Japan, under the WTO dispute settlement procedures, for alleged non-compliance with multilateral trade rules.

The results of the mobilization of this wide set of policies were disappointing. Aggregate industrial production did not recover and was, in 2014, below its pre-crisis level, despite the growth recorded by some specific sectors (i.e., the auto sector). The perception of a deep crisis affecting Brazilian industry became widespread. However, it seldom led to criticism of the import substitution measures prescribed by the government to deal with the crisis.

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This crisis, and the failure of the protectionist measures to address it, has generated some questions among private actors, but they seldom attribute the poor performance of industry to protectionism. There is a diffuse sense that the deterioration of Brazilian industrial competitiveness is the result of the sharp increase in domestic costs—the so-called *custo Brasil* (Brazil Cost)—since the second half of the 2000s. But very few analysts relate the competitiveness gap to the poor performance of productivity in the industrial sector or to the fact that Brazil continues to be one of the most closed economies in the world.

In theory, 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 *Partido dos Trabalhadores* (party in power) largely overlaps with both the import substitution strategy of industrialization

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and the historically dominant paradigm of foreign economic policy.

An increasing number of analysts and business organizations perceive the absence of Brazil from the network of preferential trade agreements as the main cause for Brazil's modest participation in global value chains. Some business organizations have recently stressed engagement in preferential trade negotiations with developed partners (EU and US) as the top priority for the Brazilian trade policy agenda. Nevertheless, they continue to reject unilateral trade liberalization.

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CONCLUSIONS

In the field of the trade and industrial policies in Brazil, the traditional mantra has been import substitution. Policy instruments have been mobilized to continuously expand the domestic industrial structure and to fill in the input-output industrial matrix. Competing paradigms and ideas geared toward going beyond import substitution and fostering productivity and innovation have gained little traction in the Brazilian debates on such policies.[4]

Despite the swings in economic activity and in industrial performance, the hegemonic paradigm of trade and industrial policy held an almost completely unchallenged position during Rouseff's first term.

Except for some academicians and think tanks, criticism of Brazil's current trade and industrial policies does not lead to comprehensive proposals promoting trade liberalization as an engine of growth and industrial structural change. So far, criticism targeting trade policy seems to owe more to economic policy preferences than to economic interests. The ideas for change are beginning to mature, but the concrete economic interests are not there yet.

In such a context, how should we understand the recent shift of Rousseff´s government in trade negotiations? Does it mean Brazil's government is moving away from protectionism?

The picture is unclear. The most likely hypothesis points to an effort to build bridges between a politically isolated government and the business sector. Trade agreements could be a part of Rousseff´s agenda in a context of economic recession and political convulsion.

This would suggest that the current shift in the trade negotiations field is not the result of a reasoned self-criticism addressing the import substitution model. Rather, it seems to be the product of a very specific set of political and economic factors and circumstances that push the government to take initiatives geared toward, supposedly, reducing its current political isolation.

ENDNOTES

1. Mercosur is a custom union, established in the early 1990s, putting together Brazil, Argentina, Paraguay, and Uruguay. Recently, Venezuela joined the group.

2. Economic interests and ideas (or economic and non-economic policy preferences) explain continuity and changes in the Brazilian trade policy. The dynamics of ideas do not derive automatically from the logic of economic interests as ideas have a relative autonomy *vis-à-vis* economic interests. See, for instance, Jamal and Milner (2013) on Egyptian economic and cultural preferences for globalization. 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)."

3. BNDES–Banco Nacional de Desenvolvimento Econômico e Social is a large public bank responsible for supporting, through credit and equity, investments of Brazilian companies.

4. To be sure, import substitution promoted structural transformation in Brazil until the late 1970s, when the strategy showed the first signals of exhaustion as an engine of economic growth. From the 1980s on, the capacity of import substitution to foster structural change stalled. But the Brazilian policy model in trade and industrial matters remained captured by the import substitution logic.

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Cite as:
Motta Veiga, Pedro da, Ph.D. and Sandra Polónia Rios. 2015. *Brazil's Trade Negotiations Agenda: Moving Away from Protectionism?* Issue brief no. 08.27.15. Rice University's Baker Institute for Public Policy, Houston, Texas.