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Trade Liberalization in Brazil: When and How?

Pedro da Motta Veiga, Nonresident Fellow, Latin America Initiative

In a previous brief co-authored with Sandra Rios,¹ we discussed the resilience of the “import-substitution paradigm” (and its protectionist toolkit) in trade and industrial policies in Brazil. This paradigm has existed for nearly five decades as the intellectual reference for the successful (at least until the late 1970s) Brazilian experience of industrialization, shared by a wide coalition of public and private players.

However, the deep economic crisis that Brazil has been experiencing for the last three years has made room for policy reforms in different areas, among which are trade and industry. Although the import-substitution paradigm remains hegemonic, debates on trade policy reform and trade liberalization are no longer taboo and have gathered some support among policymakers (mainly from the Ministry of Finance), academicians, and a few business leaders.

Regardless of the position adopted in relation to trade policy reform in Brazil, it is necessary to recognize that the domestic and external political conjuncture does not favor such a reform. On the domestic front, the government has focused almost exclusively on fiscal matters in an effort to reverse the deep deterioration of public finances at the national and the subnational levels. On the external front, the political mood is anything but favorable toward liberalization initiatives, be they unilateral or negotiated.

This brief discusses the outlook for trade policy reform in Brazil during President Michel Temer’s term (which ends in December 2018) and the challenges and

dilemmas in the trade policy arena that will be faced by any succeeding government.

FROM THE TRADE LIBERALIZATION OF THE 1990s TO THE CURRENT SITUATION

During the first half of the 1990s, Brazil adopted a moderately ambitious unilateral trade liberalization policy. This movement was complemented by the consolidation of maximum tariffs for industrial and agricultural goods by the World Trade Organization (WTO)² and the establishment of MERCOSUR’s customs union.

Since then—approximately a quarter of a century later—no other trade liberalization moves have been implemented by Brazil, which sets the country apart from practically all other emerging economies, including China and India. Today, according to the World Bank, Brazil’s economy is among those most closed to external trade in the world³ and has higher tariff levels in comparison to those implemented by other large developing countries (see Figures 1 and 2).

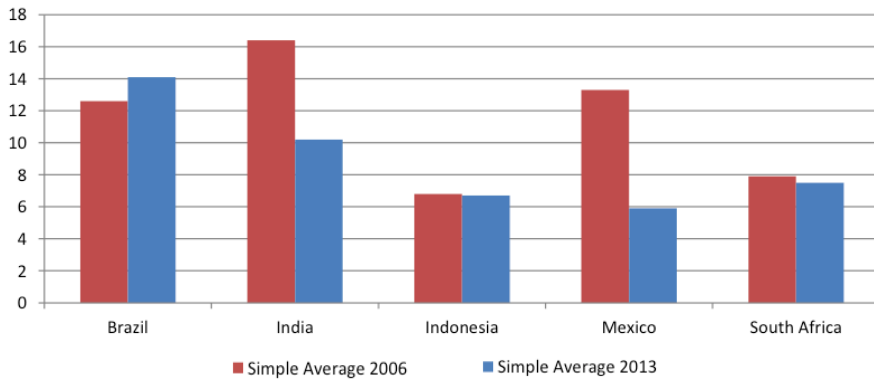
In addition, in 2010 Brazil started to adopt a broad range of protectionist industrial and trade policies that favored domestic production.⁴ At the same time, trade negotiations became less relevant before returning to the policy agenda in 2015, when the failure of the industrial and trade policies adopted in 2010 became evident.

As is well known, these policies had disastrous effects. To begin with, they did not achieve their main goals of defending



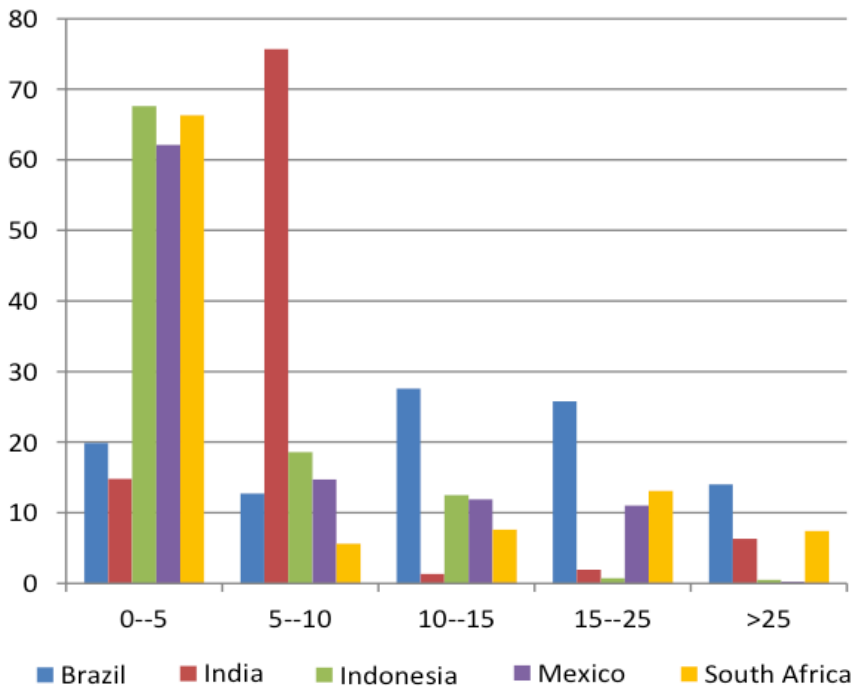
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FIGURE 1 — MOST FAVORED NATION TARIFFS OF LARGE EMERGING ECONOMIES, 2006 AND 2013: SIMPLE AVERAGE (% AD VALOREM)



SOURCE WTO, World Tariff Profiles 2006 and 2014.

FIGURE 2 — TARIFF PROFILES OF SELECTED EMERGING ECONOMIES: TARIFF DISTRIBUTION BY INTERVALS (% AD VALOREM)



SOURCE WTO, World Tariff Profiles 2014.

Brazilian industry from the increase in imports and of mitigating the ongoing deindustrialization process. Industry did not even return to its pre-crisis (2008) production levels, and industry’s contribution to the GDP continued to decline through the following years.

Besides that, the adopted policies—especially the incentives granted to industry—have contributed to the significant worsening of Brazil’s fiscal situation in recent years. This fiscal scenario limits prospects for the resumption of economic growth after more than two years of a strong recession.

As if that were not enough, a significant portion of the policies that were adopted in 2010 was recently condemned by the WTO, the very trade negotiation forum historically prioritized by Brazilian diplomacy.

This is the situation at the beginning of 2017, approximately six months after the impeachment of Dilma Rousseff, whose administration was responsible for the policies mentioned above. With the inauguration of a new president, discussions on the reasons for the failure of the developmentalist experiment have been gaining traction, fostering a debate on the revision of trade and industrial policy.

Consequently, Brazil’s economic policy agenda is changing to one that seeks to prioritize fiscal balance, private capital investments, and the growth of economic productivity.

As occurred in the early 1990s, the debate on trade policy reform has reappeared on the agenda as part of a wide “revisionist” proposal that resets the relationship between the state and the economy. This reset is obviously propelled by the collapse of the developmentalist growth model with its high social and economic costs.

However, there is no doubt that the political and economic circumstances—both domestic and international—in which trade reform is again being discussed are currently unfavorable. Such circumstances make a more ambitious trade reform practically unfeasible under the Temer administration. Furthermore, they generate complex dilemmas in the management of a trade liberalization policy for the next administration.

THE UNFAVORABLE CONTEXT AND PROSPECTS FOR REFORM

At the domestic level, the Temer administration—which replaced Rousseff’s after her impeachment—has made battling the deep fiscal crisis now consuming the federal government and many subnational entities its top priority. Fiscal adjustment measures and the reform of the welfare system will absorb almost all of the political capital resources of the current government, whose mandate will end in less than two years.

In this context, it cannot be expected that the government would lead the revision of trade policy, a subject that still faces strong resistance in the private sector and in several segments of society (business, academia, and policymaking). Even those who support trade policy reform recognize that the domestic political climate is unfavorable for change.

With almost no fiscal space for policies to support exports and within a domestic political environment that rejects unilateral measures for import liberalization, the only track currently available to trade policy reform is via preferential negotiations, since the multilateral options have stagnated.

However, an examination of the ongoing negotiations suggests that their evolution is happening at a slower pace than anticipated. Negotiations with Mexico, which were initially expected to conclude June 2016, will probably be extended through 2017. Negotiations with the European Union face significant political resistance in some European countries and are not likely to be concluded before 2018.

Generally speaking, in the field of trade negotiations, Brazil seems to be paying the price of its late entrance into the arena. Today, the country faces an international scenario that is adverse to ambitious trade agreements. Therefore, as far as its “negotiation track” is concerned, the trade policy reform agenda is stumbled not only by domestic constraints, but also—and even more so—by external restrictions.

In fact, in contrast to what occurred in the early 1990s when Brazil initiated

its unilateral trade liberalization,⁵ the international political environment has become increasingly more unfavorable to trade liberalization and negotiation initiatives. This has been a typical phenomenon in developed countries, and the risks of the emergence of a protectionist surge or even a trade war have grown significantly since Donald Trump’s election.⁶

Therefore, a review of the developments observed in the domestic and international spheres suggests that Brazilian trade policy will be subject to continued inertia over the next two years; that is to say, no major changes will occur, and trade policy will largely remain the same. Specific adjustments to limit protectionist excesses in industrial and trade policies and continuing with trade negotiations in the midst of resistance (both within Brazil and from other countries) will most likely constitute the core of the Temer administration’s trade policy until the end of 2018.

THE DILEMMAS FACING A TRADE REFORM IN BRAZIL

Substantive changes in the orientation of trade (and industrial) policy will only be possible with the inauguration of a new president in January 2019, and such changes will obviously depend on the political orientation of the new administration.

On one hand, the perspective that Brazil’s economy will start to recover and grow in 2017 makes it possible to anticipate a domestic political environment that will be more favorable to the implementation of an ambitious trade policy reform in the coming years. However, if the new administration opts for a comprehensive revision of Brazil’s trade policy, some complex policy dilemmas will necessarily be faced.

The first such dilemma concerns Brazil implementing liberalizing reforms in a world where the winds blow in the opposite direction, toward protectionism and a rejection of globalization. This pertains to a criticism that has strong political appeal, but it is hardly convincing considering that Brazil’s economy remained quite closed

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when the vast majority of the developing economies moved toward opening trade to the world. Therefore, trade liberalization in Brazil would only bring the country's economy closer to the standards of protection present in the rest of the world, especially among emerging nations.⁷

A second policy dilemma involves the trade reform model: should it be unilateral or conditioned upon reciprocity to be pursued through trade negotiations? In the current debate in Brazil, policymakers and diplomats clearly demonstrate a preference for negotiated agreements. According to the defenders of this position, preferential agreements should be the means of Brazil's reintegration into the global economy, as they would ensure reciprocity to the opening of its economy. In this sense, such agreements would be a policy option superior to the unilateral opening of the economy by definition, as negotiations would ensure better market access for Brazilian exports in exchange for Brazil's economic opening. This position also carries an argument with strong political appeal: why open the economy without asking for anything in return? There are, however, a few problems with this line of thought.

First, as previously mentioned, the international political environment—especially surrounding trade agreements—is plainly deteriorating. Brexit and the United States' withdrawal from the Trans-Pacific Partnership are clear examples of this trend. This situation jeopardizes the very idea that in a relatively short period of time, trade agreements would be able to reintegrate the Brazilian economy into the world.

Second, as the Brazilian economy is much more closed to trade than its partners (both small and large), any trade negotiation will be perceived in Brazil as asymmetrical and “unfair.” Other countries involved in the negotiations will be coming from a status quo that reflects already completed liberalization moves that generate lower tariffs, mainly in the industrial sector. Brazil, however, will be coming from a higher level of protection, which will have to be reduced substantially in order for the agreements to generate free trade areas. Therefore, if

the intention of the “negotiated option” via preferential agreements is to ensure reciprocity between concessions and gains for Brazil and to make liberalization more politically palatable, the chances that it will be effective are slim.

The third problem with this argument has to do with the perception that the trade reintegration of Brazil into the world economy is an essential component of a new growth model based on increasing productivity. From this point of view, the protectionist trade policy is one of the main factors contributing to the long-lasting “semi-stagnation” of the Brazilian economy and to the lackluster performance of productivity shown by Brazil in the last 35 years.⁸

In addition, Brazil cannot wait more than 10 years until the agreements are negotiated and start to have an impact on the economy's level of openness. In this sense, the reintegration of the Brazilian economy into the world would have to come about mainly through a trade liberalization process that should include the negotiation of agreements but cannot relinquish the unilateral dimension, which does not depend on reciprocity.

CONCLUSION

Despite the resilience of Brazil's protectionist policy and the “anti-globalization” wave gaining traction in developed countries, the debate on trade policy reform has been intensifying. An increasingly accepted idea is that even if protectionism helped Brazil to establish and grow its industrial sector, for many years the negative effects of protectionism have surpassed its benefits.

However, more significant shifts in trade policy will have to wait until the next administration takes office and will therefore depend on the results of the October 2018 election. Even if a future administration opts for ambitious trade reforms, the dilemmas it will face are not trivial and resistance to change will be great. Carrying out a substantive trade reform in Brazil will require the government's conviction that economic openness will benefit the country regardless

of its partners' reciprocity, and that the costs of such an opening can be managed by intelligent compensatory policies.

ENDNOTES

1. Pedro da Motta Veiga and Sandra Polónia Rios, *Brazil's Trade Negotiations Agenda: Moving Away from Protectionism?* Issue Brief no. 08.27.15 (Houston: Rice University's Baker Institute for Public Policy, 2015).

2. By consolidating maximum tariffs in the WTO (making them "bound tariffs"), a country legally commits to not increasing them beyond the established levels. The bound tariff levels of any WTO member country may be equal to or greater than the effectively applied tariffs. In Brazil, the bound tariffs are, in the vast majority of the cases, higher than the applied levels.

3. The World Bank, "World Development Indicators 2016," <http://data.worldbank.org/data-catalog/world-development-indicators>.

4. Da Motta Veiga and Rios, *Brazil's Trade Negotiations Agenda*.

5. The 1990s were characterized in Latin America by the strong hegemony of the liberal public policy paradigm that favored trade liberalization, the privatization of state-owned assets, and the end of public monopolies in sectors such as oil, energy, and telecommunications.

6. But it is important to observe that the data referring to the imposing of protectionist measures affecting commerce and investments in the last years do not confirm the hypothesis that the anti-globalization wave would have already generated a protectionist surge. WTO, *Report on Trade Measures (Mid-May 2016 to Mid-October 2016)*, https://www.wto.org/english/news_e/news16_e/g20_wto_report_november16_e.pdf.

7. These countries do not register "protectionist surges" and also are not among the critics of globalization.

8. Edmar Bacha, "Saída para crise tem mão dupla" (working paper, Instituto de Estudos de Política Econômica/Casa das Garças, Rio de Janeiro, 2017).

AUTHOR

Pedro da Motta Veiga is a nonresident fellow for the [Latin America Initiative](#). He also serves as director of CINDES (Centro de Estudos de Integração e Desenvolvimento), a think tank focusing on Brazil's foreign economic policies and economic integration, based in Rio de Janeiro.

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