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# Brazil: Increased International Integration Imposes Limits on Protectionist Policies

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When Brazil's trade balance began to reflect the effects of the global economic and financial crisis, the Brazilian authorities decided to implement automatic import licensing procedures across a wide range of products. However, facing strong negative reactions from the business community and from public opinion, the measure was revoked only three days after it had been adopted.

The increased share of imported goods in the Brazilian industrial production chain has reduced the scope for the adoption of widespread protectionist measures by government authorities. This paper examines how the increased international integration of production processes has restricted the opportunity for protectionist trade policies by highlighting two recent Brazilian experiences.

The first section of this paper presents the recent evolution of Brazilian trade flows; it shows how the effects of the economic crisis were first reflected in the performance of exports. The reaction of imports came some months later, and resulted in a trade deficit for the first time since 2000.

The second section describes two recent cases of the adoption of, or the intention to adopt, protectionist measures by the Brazilian government authorities which were halted by the reactions of the business community and by public opinion.

The third section presents evidence on how the share of imports in the industrial sector in Brazil has increased during the last decade. This has also been the case for the export coefficient in many sectors, which implies that industrial production for domestic consumption and for exports is today significantly more dependent on imported goods compared to the first half of the 1990s.

The main findings and conclusions are presented in the final section.

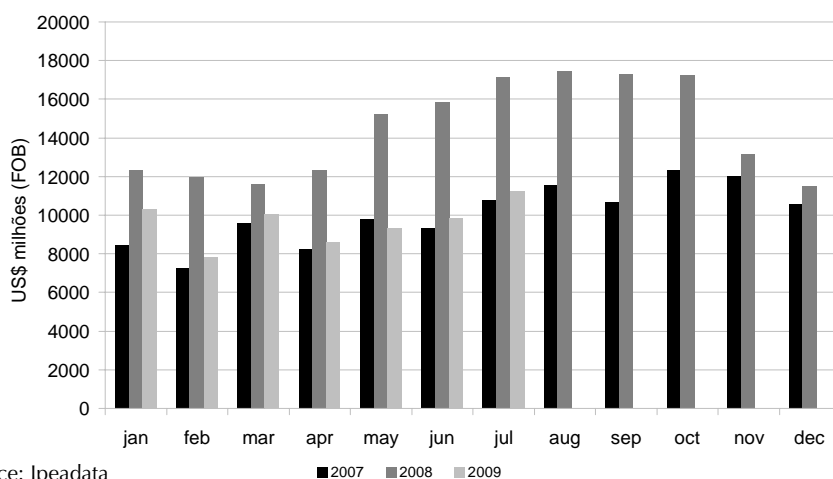
## **1. Recent evolution of trade flows**

The outbreak of the international financial crisis hit Brazilian foreign trade at a time when it was in strong expansion – Brazilian exports grew by 27% and imports by 51% in the twelve-month period up to September 2008 compared to the same period the year before.

However, the effects of the crisis on trade flows were immediate: the rate of growth of Brazilian exports declined rapidly over two months, and became negative from December 2008 onwards.

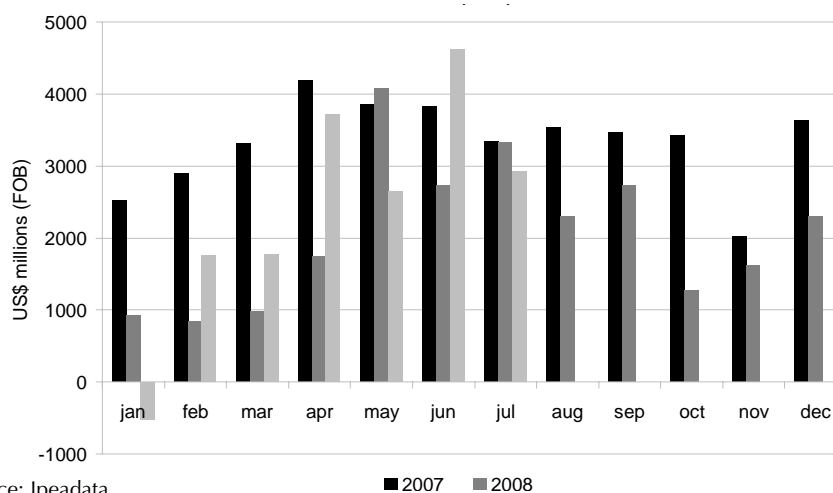
Impacts on imports were more gradual. In the three months that followed the beginning of the crisis, the growth rate for imports declined, though remained positive before becoming negative from January 2009 onwards.

**Figure 6.1** Brazilian imports – monthly value, US\$millions (FOB)



Source: Ipeadata

**Figure 6.2** Brazilian trade balance – monthly value, US\$millions (FOB)



Source: Ipeadata

The trade balance surplus fell sharply in October 2008 – US\$ 1.3 billion compared to US\$ 2.7 in the preceding month and US\$ 3.4 in the same month of the year before. Even though there was a significant recovery in the trade surplus during the following two months, in January 2009 the trade balance registered a US\$ 529 million deficit. However, since February 2009 the trade balance has once again become positive.

The evolution of the trade balance in the first months of the crisis has concerned some parts of government. The trade balance had not registered a larger deficit than the one observed in January 2009 since November 2000. At the end of January 2009, in a move that surprised analysts and the business community, the public authorities responsible for the control of trade operations announced the requirement of automatic import licenses for a large set of goods.

## 2. The measures

This section reports two cases in which the business community reacted negatively to the implementation of import licensing procedures in Brazil. In the first case, the authorities implemented automatic licenses for a wide range of products, but subsequently had to scale back in response to criticism from the private sector.

In the second case, the adoption of non-automatic import licenses as a retaliation to Argentinean protectionist measures against Brazilian exports was being considered by some areas of the government. The National Confederation of Industry sent a letter to the Ministers of Foreign Affairs and of Development, Industry and Trade, stating that the business sector preferred recourse to the WTO dispute settlement mechanism rather than the imposition of non-automatic licenses.

### 2.1. Automatic import licensing

At the end of January 2009, the government of Brazil (Ministry of Development, Industry and Trade, MDIC) adopted automatic import licensing procedures for a wide range of products. The measure affected 24 chapters of the harmonized system (HS), concentrated mostly in equipment, machinery and electronic products. These chapters represented 71% of the total value imported by Brazil in 2008<sup>1</sup>.

The Brazilian government stated in a press release by MDIC that the action taken was in full accordance with Article 2 of the Import Licensing Agreement of the WTO, which determines that automatic import licenses must be approved in all cases and within 10 working days. (MDIC, 2009)

The measure was implemented, according to the Minister of Finance, as a means of monitoring Brazilian trade statistics and the trends in Brazilian imports (Reuters Online, 2009). This explanation was further reinforced by MDIC, which also referred to the need to identify discrepancies in trade statistics (MDIC, 2009). The authorities stated that the measure would not constitute a barrier to imports and that the release of the import licenses would be carried out expediently.

The press, however, interpreted the measure as an attempt by the government to curb the continuous increase of imports of certain products. Miriam Leitão, economic commentator for the *O Globo* newspaper decried the measure, arguing that:

The decision by the Minister of Development, Industry and Foreign Trade to create, without any prior discussion, barriers to Brazilian imports is scandalous (...) this site has heard from many worried exporters (...) you know what it means: the government doesn't know it but Brazilian trade is more sophisticated, more complex, and the exporter is also an importer and one thing depends on the other. (*O Globo*, 2009)

In fact there was a strong reaction to the measure from several sectors of Brazilian industry. The president of the Brazilian Association of the Electrical and Electronics Industry, for example, declared that "the situation is very delicate because of the high

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1 For more details, see related GTA Notification: Brazil: Automatic import licensing for selected products. Measure #0370. <http://www.globaltradealert.org/measure/brazil-automatic-import-licensing-selected-products>.

dependency on imports of the electrical and electronic sectors". He went on to say that "if the problem is not solved in two or three days, many companies will have to stop production". (*Estado de São Paulo*, 2009)

In the automotive sector, there was also lobbying for the removal of products from the list due to the risk of paralyzing production – "After meeting with [Finance] Minister Mantega, auto producers and autoparts suppliers were successful in removing from the import license requirement the inputs and parts needed for the production of automobiles". The President of the National Syndicate of the Industry for Autoparts argued that "these are items that may stop production" (*Estado de São Paulo*, 2009).

The measure was revoked three days after its announcement by order of President Luiz Inácio Lula da Silva, who called it a "phenomenal mistake", since it went against the free-trade orientation defended by the government in multilateral forums (*Estadão*, 2009). Upon announcement of the cancellation of the measure, Finance Minister Mantega justified its adoption on the grounds that:

The international crisis decreased the commodity exports of Brazil and other countries. This created a preoccupation with the performance of the trade balance. An increase in the competition in international trade was observed, and because of this, the Ministry of Development decided to adopt a measure to better monitor our imports. (*Estadão*, 2009).

However, Mantega acknowledged that the measure had been "misunderstood", "misinterpreted" and caused "noise", alluding to the intense criticism directed at the government by the Brazilian industry and trade partners. (*Estadão*, 2009)

Secretary of Commerce Welber Barral denied that the automatic import license requirement, during the three days in which it was active, influenced the trade balance or affected importers. Barral was cited as saying "there was a series of misunderstandings and noises. What they did was a Shakespeare comedy and a lot of noise for nothing". For the Secretary of Commerce, the import license requirement was "wrongly" interpreted as protectionist. (*Folha Online*, 2009)

The main point here is not whether or not the measure had protectionist purposes – indeed, automatic licensing regimes are not necessarily trade barriers. The relevant message is that the industrial sector demands predictability and rapidity in the customs clearance operations. There is no more room for discretionary measures that may result in delays in the clearing of imported goods that will enter into the production process of industrial goods – many of them destined for export.

## **2.2. Non-automatic import licenses as retaliation to the Argentinean measures**

In July 2009, press articles indicated that some areas of the government were studying the possibility of adopting non-automatic import licenses as a form of retaliation to the various restrictions that Brazilian products have been facing in Argentina (*Valor Econômico*, July 1st, 2009)<sup>2</sup>.

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<sup>2</sup> For more information on Argentina-Brasil trade relations, see related GTA notification: Brazil-Argentina: Managed trade on powdered milk imports from Argentina. Measure # 0379, <http://www.globaltradealert.org/measure/brazil-argentina-managed-trade-powdered-milk-imports-argentina>

Brazilian exporters have identified three types of instruments adopted by Argentina as the main obstacles to their sales in that country: (i) the increase in the number of products subject to non-automatic licensing, between October 2008 and March 2009, and the failure of Argentinean authorities to comply with the maximum expedition period defined by the World Trade Organization's (WTO) Agreement on Import Licensing procedures (60 days); (ii) the large number of products having to pay antidumping duties; and (iii) quantitative restrictions as a result of sectoral agreements to limit exports.

Brazilian exporters' main complaint is the delay in the liberation of the non-automatic import licenses and their discriminatory use in relation to Brazilian products, which are amongst the most affected. In fact, according to Rozenwurcel (2009), imports originating from Brazil represent 30% of the imports subject to the non-automatic import licensing regime. However, according to this author, many estimates suggest that the non-automatic licenses represent only 2 percentage points of the fall in Argentinean imports between the first trimester of 2008 and the first trimester of 2009. Nevertheless, this regime has been very important for the performance in the imports of some specific sectors, such as capital goods and durable consumer goods, of which Brazil is one of the main suppliers.

Regardless of the frequent complaints from several different Brazilian industrial sectors, the business sector did not approve of the proposal for the adoption of non-automatic import licenses for products of Argentinean export interest. In an anticipatory move, the National Confederation of Industry (CNI) sent letters to the Ministers of Foreign Relations and of Development, Industry and Foreign Trade in which it affirms:

Recourse to the WTO's dispute resolution mechanism is a more appropriate response. The adoption of non-automatic licenses on imports is a bureaucratic discretionary process which increases costs and uncertainties for Brazilian businesses integrated into international value chains. ([www.cni.org.br](http://www.cni.org.br), July 22nd, 2009)

In the same manner as the reaction of entrepreneurs to the automatic import license measure in January 2009, the manifestation of the National Confederation of Industry shows that the scope for the government to adopt wide-ranging import restricting measures has been reduced. Additionally, it shows that the perception of the importance of the WTO as the adequate forum for the resolution of the country's trade disputes has increased.

The reaction of the business sector most certainly may have contributed towards preventing recourse to non-automatic import licensing as a form of retaliation to the Argentinean practices. As a matter of fact, up until now the Brazilian government has not adopted this kind of measure. However, it was not sufficient to persuade the Brazilian government to present a formal complaint against these practices, either in the Mercosur institutions, or in the WTO.

The Brazilian authorities – in particular the diplomatic corp – continue to prefer to resolve bilateral conflicts with Argentina through the negotiation of sectoral agreements of export restrictions between the private sectors of both countries. Although they recognize that the use of non-automatic import licenses is jeopardizing Brazilian exports to Argentina, they seem to believe that by accepting sectoral "voluntary"

agreements, Brazil is contributing to the re-industrialization of the neighbor country.

In a meeting with the Federation of Industries of the State of São Paulo (FIESP) on the 5th of July, Foreign Relations Minister Celso Amorim tried to convince the private sector to support the voluntary agreements, arguing that the non-automatic import licenses have affected 10% of Brazilian exports to Argentina in 2008. The Argentinean Foreign Ministry estimates the impact to be even less, affecting not more than 4% of Brazilian exports to the country (Portal Vitrine, 2009). The resistance of a larger number of sectors to negotiate or to renovate old agreements of these types shows that this strategy is wearing out.

The two cases reported in this section support the view that the scope for domestic policies intended to restrict imports are losing the support of the business sector and of public opinion in Brazil. Government authorities must take into account that industrial production is increasingly dependent on imported goods. Companies need predictability and swiftness in the importation process. This is also true for products destined for export, as is shown in the next section.

The second case also shows that the business community prefers to rely on the legal recourse of the WTO dispute settlement mechanism to deal with trade conflicts with trading partners rather than through the adoption of retaliatory measures that hamper imports.

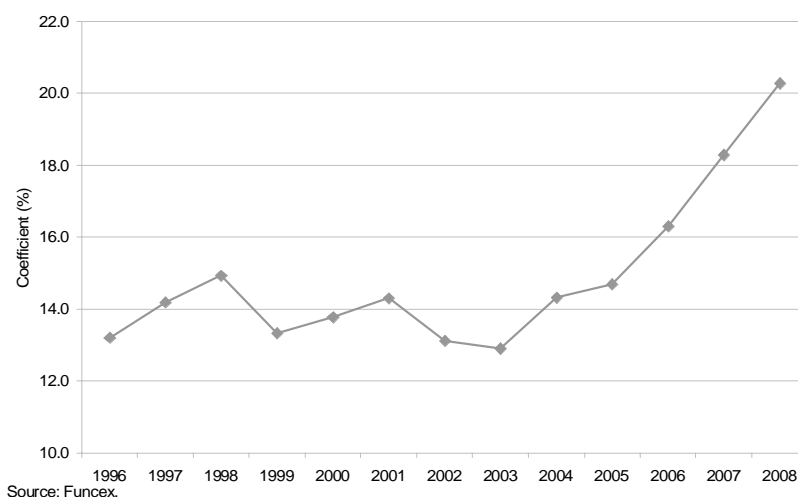
### **3. Increased dependency on imports: a limit to import restrictions**

This section provides information on how the participation of imported goods in industrial production has increased in the last decade. In the beginning of the trade liberalization process in Brazil the growth in the value of imports was due in large part to the reduction of import tariffs and substitution of domestic production. But in recent years, imported goods have been mostly complementary to domestic production.

The trade liberalization process in Brazil in the first years of the 1990s promoted a significant increase in the import penetration coefficient (ie, the share of import value in industrial apparent consumption) of the Brazilian industry (at constant prices), which went from 5.3% in 1990 to an average of 15% in the last five years of the decade. This was a period of low growth in consumption and a fall in industrial production, with the exchange rate remaining devalued (Puga, F.P, 2008). Therefore, in this period the growth in the import penetration coefficient can be for the most part attributed to the liberalization of imports in the period 1991-1994.

Following a period of growth up to 1998, the import penetration coefficient oscillated between 13% and 15% until 2003, when it began a sharp growth trajectory, which accentuated in the period 2006-2008. In this period, contrary to what was observed in the nineties, the growth in imports was stimulated by a strong acceleration in domestic demand. The volume of industrial production grew at rates of approximately 5%, being complemented by imports in order to meet apparent consumption, which grew by approximately 5.9% between 2004 and 2007. One can observe during this period a high level of complementarity between domestic production and imports.

**Figure 6.3** Industry import penetration coefficient – constant prices (base year 2006)



**Table 6.1** Industry import penetration coefficients at constant prices (%) selected sectors – base year 2006

Sector	1996	2008	Percentage point change
Medical, precision and automated instruments	30.1	65.2	35.1
Electronic and communication equipment	15.2	47.9	32.7
Chemicals and chemical products	13.7	26	12.3
Machinery and equipment	24.2	32.6	8.4
Other transport equipment	28	35.5	7.5
Leather and footwear	3.3	10.1	6.8
Electrical machinery and apparatus	20.7	26.5	5.8
Office, accounting and computing machinery	39.2	43.7	4.5
Total manufacturing industry	10.6	18.6	8

Source: Funcex. Sectors according to Brazilian CNAE classification.

**Table 6.2** Industry export coefficients at constant prices (%) selected sectors – base year 2006

Sector	1996	2008	Percentage point change
Leather and footwear	17.6	34.1	16.5
Electronic and communication equipment	1.8	17	15.2
Other transport equipment	30.6	45.3	14.7
Machinery and equipment	14.4	20.4	6
Electrical machinery and apparatus	11.5	17.2	5.7
Total manufacturing industry	9.4	17.5	8.1

Source: Funcex. Sectors according to Brazilian CNAE classification.

The increase in the import penetration coefficient in Brazil between 1996 and 2008 was particularly remarkable in the following sectors: medical, precision and automated instruments, electronic and communication equipment and chemical products. Other sectors such as machinery and equipment, other transport equipment, electrical machinery and apparatus and office, accounting and computing machinery, which already had high import penetration coefficients, also presented growth in this indicator.

In addition to the growth in domestic demand, the increase in the Brazilian industry's export coefficient also seems to have contributed to the growth of the import penetration coefficient. Some of the sectors that experienced a significant increase in their export coefficient experienced simultaneously growth in their import penetration coefficients. For example, the electronic and communication equipment sector increased its export coefficient from 1.8% in 1996 to 17% in 2008. During this period, the import penetration coefficient of the sector increased by 32.7 percentage points – from 15.2% to 47.9%.

Despite Brazil's relatively low degree of openness – 21.3% in 2007, compared to 36.7% of developing countries – the degree of integration of imported products into the domestic production chain has increased significantly in the current decade. This tendency, in conjunction with 'just-in-time' practices – stimulated by the high interest rates in the Brazilian economy – has increased the importance of swiftness in the process of customs clearance and predictability of import operations.

#### **4. Conclusion**

The main purpose of this paper was to discuss how the increasing global integration of production process imposes limits to the imposition of widespread protectionist measures. Indeed, after the outbreak of the international economic crisis there was a general concern that there would be an upsurge in protectionism. One year later, we realize that many countries have been adopting protectionist measures, but most of them are sector or product specific. It seems that the scope for widespread import restriction policies has shrunk.

The two cases reported in this paper show that there was no business support in Brazil for Government initiatives aimed at controlling imports or imposing delays on customs clearance for a wide range of products. The growth in the imports penetration coefficient in the last years came together with the increase in domestic production. There is an increased level of complementarity between domestic production and imports in the sectors in Brazil.

The relevant message is that the industrial sector demands predictability and rapidity in the customs clearance operations. There is little scope for discretionary measures that may result in delays in the customs clearance of imported goods that will enter into the production process of industrial goods – many of which are destined for export.

The increased integration of the Brazilian production process to the flows of international trade has reduced the scope for the adoption of discretionary and sweeping import control measures. Although some business lobbies continue to pressure for protection in specific sectors, the high dependency on imported products in many

economic sectors has stimulated negative reactions to measures that reduce the transparency and increase the discretion in the administration of external trade in Brazil. This has been accompanied by an increased valorization of the legal mechanisms of the multilateral trade regime.

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