Protectionism with limits

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Last month the government announced a list of 100 products—mostly auto parts, furniture, plastics, steel, and pharmaceutical inputs—on which tariffs were being raised for the next year with the option to renew for an additional year. Average tariffs went from 12–14% to 25%. The hike should affect about 4% of the country’s total imports (US$5 billion of US$130 billion total imports), but these figures are likely to go up: the government is considering adding another 100 products to the list in the next couple of weeks.

These protectionist measures are driven mainly by administration concerns about the competitiveness of specific industries at a time when growth is lower than anticipated. Earlier this year the government announced measures to benefit the local automotive industry through tax hikes on imported cars. Shortly thereafter Brasilia decided to review its automotive trade deal with Mexico, ultimately limiting auto imports from that country. In the telecom sector, international carriers have complained about import restrictions that will be brought about by stringent local content clauses in the 4G wireless airwave auction held in June.

But although it is unlikely that these measures will be reversed even in the medium term, there are limits to how far protectionism can go as a policy driver in the longer term. Since one of President Rousseff’s main policy goals is to keep interest rates at a lower equilibrium level for the rest of her term, it is reasonable to expect that the government will be responsive to any challenges that might arise from inflationary pressures and relax some import restrictions. So in a scenario where economic activity rebounds, with a possible impact on prices, the likelihood that the government would resort to other measures rather than having the central bank raise rates increases considerably. Certainly, in that case, a reversal of some protectionist measures would be high on the list of policy options.

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Another limit to the government’s protectionist stance is the possibility of retaliation by important trade partners. With regard to the auto sector, the government was responsive to concerns that automakers had voiced. Earlier this month a new automotive regulatory framework (Inovar Auto) was announced that seeks to incentivize local production through tax reductions if automakers invest in research, higher local content, and fuel efficiency. In essence, to mitigate the risk of retaliation at the World Trade Organization, the administration altered benefits that were initially intended to limit imports by easing import restrictions for automakers that met certain requirements. Some automakers have already reacted positively by reaffirming previous investment plans.

Moreover, much of the apparent proclivity for more protectionism has to do with the government’s response to concerns voiced by powerful domestic industrial groups, as is the case with the auto sector. In the longer term, it is unlikely that a protectionist bias will arbitrarily encompass other sectors. Rather, these types of measures will continue to target specific sectors and be driven by industries that are able to voice their interests more intensely. Ultimately, the government will likely have to be pragmatic and try to walk the narrow line: protecting certain sectors yet attracting foreign investment and maintaining good relations with trade partners.

Finally, in the longer term, because the global economic slowdown negatively impacts Brazil’s export sector and trade surplus, the government will be pressed to reconsider some aspects of its trade policy. In the last decade or so the failure of Brazil and Mercosur to negotiate major trade deals was overshadowed by high commodity prices and booming demand from China. Today less favorable winds are already affecting Brazil’s exports. Through August the country’s trade surplus was down by more than 30% year-to-date, from US$20 billion to roughly US$13 billion, and half of the loss is from just one partner, China. This will surely raise the importance of free-trade negotiations in the next few years.

In fact, last month Brazil’s foreign minister, Antonio Patriota, acknowledged that in a prolonged situation of low growth, the government, along with other Mercosur partners, will have to consider a more proactive, less defensive trade policy. The recent decision to open to public consultation Mercosur’s talks with Canada and the European Union may be read as an incipient sign of this rising concern.