Lula’s government ended with a noticeable contrast: a successful international image for Brazil, but a poor trade balance. Although President Rousseff may lack Lula’s charisma in international forums, export businesses hope her administration can reverse the deterioration in the trade balance, although the outlook for 2011 is gloomy.

BRAZIL’S TRADE WOES

Solange Monteiro, Rio de Janeiro
That old enemy, the “Brazil cost” (deficient infrastructure, vast bureaucracy, and high taxes), has historically undermined the competitiveness of the country’s exports. Now it is exacerbated by other obstacles, such as an appreciating Brazilian real and an unbalanced relationship with our main trading partner, China, which has heavy demand for Brazilian commodities but whose manufactures threaten our own, both domestically and abroad.

“Today, we are passive passengers in the international market,” said José Augusto de Castro, vice president of the Association of Foreign Trade of Brazil (AEB). Vera Thorstensen, trade specialist at the Getulio Vargas Foundation of São Paulo and former consultant to the World Trade Organization, agrees, commenting that “Brazil’s surplus depends considerably on international commodity prices, not on Brazil.”

As Brazilian manufactured goods have become less attractive to the rest of the world, the trade deficit of the industrial sector has surged alarmingly to US$37 billion in 2010, a 125% increase over 2009, according to the Ministry of Development, Industry and Trade (MDIC). “We don’t see recovery to 2008 pre-crisis levels,” says Lia Valls, coordinator of the Center for the Study of Foreign Trade of the Brazilian Institute of Economics. Can this situation be reversed in the short term?

Alessandro Teixeira, executive secretary, pledged that MDIC is preparing to act on behalf of entrepreneurs. “We are discussing the Productive Development Plan 2 (PDP2), which addresses cost reduction, modernization, and competitiveness,” he said. “We will also address the most sensitive and labor-intensive sectors: textiles and garments, leather and footwear, and machinery and equipment.” The details of PDP2 are not yet public, but industry expectations are great. “Minister Fernando Pimentel is aware that we are in a crisis; I hope that actions will speed up,” says Humberto Barbato, president of the Brazilian Association of Electric Electronic (Abinee). AEB’s de Castro thinks time to maneuver in the short term is getting tighter. “Up to now, export stimulus packages were little bundles, with measures announced but unfulfilled. We can no longer place ineffective bets.”

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<th>2010</th>
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<tr>
<td>Current account</td>
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<td>Brazilian investment abroad</td>
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Source: Central Bank of Brazil. *Projections
DEINDUSTRIALIZATION

At the end of last year, concerned about the worsening trade deficit, the MDIC began to warn that the Brazilian economy might be “deindustrializing.” In a recent study, however, staff of the Brazilian Agency for Export and Investment Promotion (APEX), found no evidence of deindustrialization but rather “an accommodation of national industry in an environment of growing domestic demand, insecurity in the international economy, and loss of export profitability,” which explains the growth of imports.

Manufacturers see a less rosy reality. The Survey of the Brazilian Association of Machinery and Equipment (Abimaq) found that between 2004 and 2010, consumption of medium- and high-technology goods — automobiles, electronics, and machinery and equipment — increased by 76%, but domestic production rose by only 40%; imports grew by 177%. Similarly, the Abinee says, exports accounted for only 11% of total revenues in the electronics sector in 2010 compared with 20% in 2005, and imports now represent 22% of electronics sales, compared to 16% in 2005.

“In the late 1980s, manufacturing accounted for 27% of GDP. Today its share is only 16%,” says Cesar Rogerio Souza, chief economist at the Institute for Industrial Development Studies (IEDI). In mature economies, he says, industry’s share in GDP declines to make room for the service sector; but in Brazil, where per capita income is three to four times lower,
there is no reason for the service sector share to expand so much.

Currently, South America accounts for 39% of Brazil’s total manufacturing exports, more than the percentage for the United States and the European Union together, but the Economic Commission for Latin America (ECLA) estimates that growth in the region will be smaller this year, says Valls.

While the share of exports to the EU has held steady in recent years, the share of exports to the U.S. has declined: total Brazilian exports fell from 25% in 2002 to 9.5% in 2010 and manufactured goods from 35% to 13%. The reasons for the drop are not clear. Valls points to currency appreciation and, more recently, a sluggish U.S. economy, but she also notes the increased activity of U.S. corporations in Asia, diverting some intra-firm trade from Brazilian exports.

In part, this was the price Brazil paid for prioritizing South-South dialogue in recent years and in the process neglecting the relationship with the U.S.

**EXCHANGE RATE**

Today, the major concern of exporters is the exchange rate: Appreciation of the Brazilian real — more than 100% during Lula’s administration — and the concurrent devaluation of the Chinese yuan has wreaked devastation on Brazil’s foreign sales.

Thorstensen of the FGV argues that Chinese exchange rate policy is undermining the World Trade Organization (WTO) system and encouraging deindustrialization in emerging countries: “China’s exchange rate has been the same for two and a half years. Nevertheless, the fact that China continues to run enormous trade surpluses suggests that its currency is undervalued, which affects all other currencies and trade flows.”

Charles Tang, president of the Brazil-China Chamber of Commerce and Industry (CCIBC) emphatically disagrees: “Brazil has an economic model of poverty: the highest interest rates in the world, exorbitant costs, an unfavorable exchange rate, and we blame all this on China.” Tang has followed the Brazilian
economy since he arrived here in the late 1970s to set up a leasing operation for Bank of Boston. He raises a basic question: “The U.S. needs to manipulate its currency to pay down its giant debt obligations, generate employment, and export more. China has pegged its currency to the dollar. U.S. GDP is 25% of world GDP, and China’s is just 8%. Why should China pay for the American outrage?” Its exchange rate is competitive because China has low levels of consumption and high domestic savings at about 22.5% of GDP.

Appreciation of Brazil’s currency also reflects internal imbalances. “For a long time the country has had to finance its public deficit by issuing government bonds that, to be attractive, have to pay high interest.” says Ambassador José Botafogo Gonçalves. He explains that these rates attract foreign capital flows, causing the real to appreciate. IEDI’s Souza says the first step in addressing the overvaluation is to discourage the entry of speculative foreign capital. One implication is that the government will have to cut public spending to allow interest rates on public debt to fall.

INEFFICIENCY
Exporters agreed that the “Brazil cost” — led by inefficient and costly infrastructure, sluggish bureaucracy, and high taxes — also must be addressed. De Castro says, “Changing the exchange rate may be the only solution in the short term, but if the rest was in order, no one would complain about it.”

Humberto Barbato of ABINEE says that industry — for which imports may reach 80% of total inputs — is seeking alternative ways to react. Barbato has proposed to the MDIC measures to offset exchange rate effects: “First, remove the taxes on labor for export products. Second, increase the current average tariff on imports from 12% to 35%, the level permitted by the WTO.” He feels that without changes in the short term, industry will also miss important domestic opportunities. “Even Petrobras [the Brazilian state oil company] is trying to reduce the required minimum percentage of domestic products in exploration platforms (60%), because it knows it can buy abroad cheaper.”

Another example is orange juice, where 98% of Brazilian production goes abroad, representing 85% of world exports. Although it is enviably productive, the industry suffers because of competition from other beverages. “Production volume has not grown for 10 years,” says Christian Lohbauer, president of the National Association of Exporters of Citrus Juices (CitrusBR). He thinks the immediate priority should be tax relief. Today, the citrus industry has R$400 million of accumulated tax credits.

Heitor Klein, executive director of the Brazilian Association of Footwear Industries (Abicalçados), seconds Lohbauer’s motion:

IN 2010, WHILE IMPORTS OF SHOES FROM CHINA FELL 58%, THOSE FROM MALAYSIA INCREASED 1,355%, TAIWAN 514%, AND INDONESIA 100%.
“The process that allows rebates of tax credits is very complex, slow, and difficult.” His industry competes directly with Chinese products in the domestic market. In January Abicalçados requested an investigation to extend antidumping action, in force against China since March 2010, to countries like Vietnam, Indonesia, Taiwan, and Malaysia, which allegedly are re-exporting Chinese products to Brazil to avoid the antidumping tariff of US$14 per pair. The association estimates that in 2010, while imports of shoes from China fell 58%, those from Malaysia increased 1,355%, Taiwan 514%, and Indonesia 100%.

CHALLENGING PARTNERSHIP

The shoe industry illustrates another challenge for Brazilian foreign trade: How to rebalance the relationship. “China has invested US$300 billion in innovation and universities and has qualified and disciplined manpower; their competitiveness has no equal,” says Fornazieri (Fesp). For Mauricio Mesquita Moreira, coordinator of integration and trade research of the Inter-American Development Bank (IDB), the initial enthusiasm for China, the new principal Brazilian customer and major partner in international forums, masked what this relationship represents...
THE INFRASTRUCTURE BOTTLENECK

More bad news for Brazilian exports: it appears that despite the Plan for Growth Acceleration (PAC), there has been no concrete progress on modernizing infrastructure to reduce transportation costs. Paulo Fleury, CEO of the Institute of Logistics and Supply Chain (Ilos), pointed out that President Lula three times started such works but “The only one ready is Tucuruí dam — which was started 30 years ago.”

Peter Wanke, professor of logistics and supply chain management, Institute for Research and Graduate Studies in Business Administration, Federal University of Rio de Janeiro, says that Brazil is experiencing a blackout. “In logistics, blackout means the inability to predict supply,” he says. “That is already occurring.” This implies a higher cost particularly for products with low added value, such as commodities. “Today, commodities record exorbitant prices, and high margins cover the extra [logistics] cost. But if demand stabilizes and competition returns, we will not be able to sweep the problem under the rug,” Wanke says. Fleury points out that the breakdown of India’s sugar crop last year pushed up demand for Brazilian products. “There were dozens of ships queuing at the port of Santos [where 70% of sugar exports are loaded], waiting on average 35 days to load. Every day a ship is waiting costs about US$50,000.”

Wanke explains that projects, permits, and bids usually take about five years, and building another five. Large companies like Vale and EBX have themselves invested in railroads and ports, “but that’s not for everyone. A dock alone involves an investment of US$300 million; every mile of railroad costs US$1 million to US$2 million.”

Fleury warns, too, that “you must think about a system, not a project in isolation.” To avoid surprises, the ideal would be that the infrastructure is always ready ahead of time. “Ports in cities like Rotterdam and Hamburg already have ‘cradles’ waiting to accommodate future growth for the next 20 years,” Wanke explains.
in the medium and long term for the Brazilian economy. Brazil’s exports to China grew by 30% in 2009 while its total exports fell by 22%, he recalls, so if it were not for China, the shock to the Brazilian trade balance would have been much more substantial. However, he calls for Brazil to take “a more aggressive stance to secure a relationship beneficial to both countries.” He says there is no magic formula: “You have to put on the table constraints and risks and seek cooperation and investment to balance the relationship, which now rests only on trade, so that discontent does not worsen.”

Moreira stresses that Brazil must also fight for elimination of barriers like Chinese tariffs on agricultural products, which are between 16% and 18%. “The agricultural sector also lives with serious non-tariff barriers, such as quotas imposed on products like sugar, maize, and cotton.” Moreira also highlights less obvious rules imposed on manufacturers, citing the case of the Brazilian Airplane Corporation, Embraer. Despite WTO doctrine to the contrary, “Embraer was notified that if it wanted to sell to China, it would have to produce there,” he says, and changes in the models produced have to be approved by the government.

The diversification necessary to balance the relationship between China and Brazil must also take into account investments. Moreira says,
“Letting China focus its investments in commodities, transport, and energy does not improve the relationship.” He cites Rio Tinto: “The Australian mining company has been hugely resistant to Chinese investment, because if a major customer becomes your partner it can force a transfer-production relationship below the ideal and the client reaps the profit.”

Charles Tang says that in 2010, besides US$10 billion that China lent to Petrobras, to be repaid in oil, China invested over US$20 billion in Brazil. “China had to invest in Brazil because it has to have some influence on the sources of strategic resources for its sustainable growth and for feeding its people,” he says.

A survey of 1,529 companies carried out late last year by the National Confederation of Industries (CNI) shows that 52% of exporters reported suffering competition from China. Domestically, 45% reported they had lost market to the Chinese; abroad, 67% said customers had started buying from China; and 4% have stopped exporting altogether.

**THE URGENT NEED**

Clearly, Brazil must immediately formulate a long-term strategy that clearly situates the nation in a global context, with greater trade liberalization and a more growth-oriented export policy.
China grew for a very simple reason,” Tang says. “It made prosperity an absolute priority, even at the cost of environmental and social injustices, which would never have been accepted by Marxism, Communism, or Maoism.” Brazil’s top priority, he says, “has never been prosperity, but monetary stability at any cost. With plan after monetarist plan, Brazil ended up with a smaller economy.”

Eduardo Lozardo, professor of the Management School of São Paulo, pointed out that while Chinese production is projected to move from 8% of global GDP to 22% over the next 40 years, for Brazil the projection is moving from producing 2.5% of world GDP to 4%. “To grow with more equitable income distribution, an emerging country has to rely on strategies of economic opening combined with a competitive industrial policy,” he says.

FGV’s Thorstensen adds that the U.S. and the EU clearly are giving priority to export policy. “China has created a growth model based on exports for 20 years. But in Brazil, this subject is completely off the agenda,” as is demonstrated by the projected US$60 billion current account deficit for 2011. Fornazieri adds that to consolidate its role in international markets Brazil cannot rely on diplomacy alone and dispense with trade: “What defines a nation as a great power is its ability to export surpluses. The predominant form of economic growth in the last 20 years has been trade oriented.”