Trade: No clear view of the future



How effective will Brazil's trade policy be in 2013? The international outlook matters, but so does what happens at home.

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AFTER NEGOTIATING A PATH full of obstacles in 2012, mainly put up by the economic problems of the major world economies, Brazilian exporters have started the year hoping to recover the ground they lost last year, when foreign sales fell by 5.3% and the trade surplus plunged 34.7%. Exporters are not sure, however, that this time road conditions will be much better.

The concentration of exports in commodities leaves the country vulnerable to international prices and demand, which are as yet undefined. Lia Valls, IBRE head of external sector studies,

points out that commodities accounted for 93% of the fall in export values in 2012, adding that "If commodity prices stabilize, it is possible that Brazilian exports will grow; the trade surplus, however, is likely to be even lower than last year if there is a recovery of the Brazilian economy." Moreover, whether the manufacturing sector can regain its competitiveness and reduce its trade deficit will depend on how it responds to the incentive policies that the government has been promoting in recent years.

Alessandro Teixeira, who is executive secretary of the Ministry of Development, Industry and Foreign Trade (MDIC), is also cautious: "We hope that 2013 will be better, but we consider it risky to set goals for exports. We still have no certainty of economic recovery in some markets. We are observing the trade performance in January and February, too, to see if the situation is becoming clearer."

For some experts, the main international risk for 2013 will be in Europe, where unemployment is high. "A deepening crisis in Europe, which accounts for 37% of world trade, could impact the country both directly and indirectly, considering that Europe is also the major buyer of China's products," says José Augusto de Castro, president, Association of Foreign Trade of Brazil (AEB).

With regard to China, the attention of Brazilian exporters is for now concentrated on recovery of its demand for iron ore, which was the Brazilian commodity most affected in 2012, when Chinese growth at 7.8% was the lowest it had been in 13 years. Marcelo Ribeiro Tunes, director, Brazilian Mining Institute, is encouraged by what he is seeing this year. He says, "We had a difficult year, but already there are signs of a gradual recovery."

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Agricultural export projections for 2013 are also encouraging, according to Marilis Romano, an analyst at Tendencias Consultoria. In 2013 agricultural exports are expected to increase 8% over 2012. Romano sees particularly positive prospects for soybeans and meat and some accommodation for sugar.

INCENTIVES FOR INDUSTRY

Manufactured exports depend mainly on what is happening economically and politically in the rest of South America, the countries that are the main customers for Brazilian industry, as well as the sector that the government has been stimulating since 2011. "There was a small gain in volumes and prices in manufactured exports in 2012, but our trade deficit in manufactures is huge," admits Roberto Giannetti da Fonseca, director, Department of Foreign Affairs and Trade, Federation of Industries of the State of São Paulo (Derex / Fiesp). What had been a deficit for manufactured goods of US$92.5 billion in 2011 grew to US$94.1 billion in 2012.

IBRE's Valls confirms that there has been little progress in manufactured exports,

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pointing out that the apparent increase in the share of manufactured goods in Brazil's exports, which went up 2 percentage points last year, was mainly because sales of iron ore fell. MDIC's Teixeira, however, believes that in 2013, "Several measures taken in 2012 will begin to show results in the first half of this year." He cites among those measures the reduction of the industrial product tax, the Program Reintegra, which gives exporters of manufactured goods tax rebates of up to 3% of their sales, and the opening of the National Bank for Economic Development credit line to finance acquisition of capital goods.

While export incentives are always welcome, there is no consensus on their effectiveness in terms of the government's industrial policy. For AEB's de Castro, the most important government initiative is payroll tax relief, which has been expanded to 42 industries. "This has given labor-intensive sectors, such as shoes and clothing, a real benefit," he says, adding that "with most of the measures, despite good intentions, the policies of the various ministries have not been integrated into a true foreign trade policy." Derex / Fiesp's da Fonseca is more confident. He ventured to predict that the government's new policies, together with the reduction in the cost of energy and the development of infrastructure, will in the next two to three years allow industry to become more competitive. For 2013, da Fonseca estimates that the trade deficit in manufactured goods will narrow by US$5 billion to US$10 billion—a modest advance but the first positive sign of recovery.

THE EXCHANGE RATE

Da Fonseca projections, however, depend on an exchange rate that is better than R$2 per U.S. dollar. The appreciation of the Brazilian real seen at the beginning of the year, however, sounded a warning sign for exporters. Although Finance Minister Guido Mantega gave reassurances that the exchange rate policy would stay focused on the search for stability, the fall of the dollar below R$2 in January generated some suspicion that this year the Central Bank will be relying on the exchange rate to contain inflationary pressure.

According to Marcelo Azevedo, economist, National Confederation of Industries (CNI), the distortion of relative prices caused by exchange rate appreciation has forced many sectors to make changes in their operations. "In recent years, several entrepreneurs have started to import inputs, which in some cases has involved changes of machinery and redesigns," he says, indicating

that, in 2011, when the exchange rate appreciated to R$1.60 per U.S. dollar, the index of import of industrial inputs was 21.7%—considered relevant to an economy like Brazil's that is not very open. For AEB's de Castro, a more depreciated exchange rate and the Reintegra program are fundamental to making manufactured goods more competitive.

ACTIVISM WITHOUT DIRECTION

For José Tavares, director, Center for Integrative and Development Studies (Cindes), the sequence of errors and successes that has occurred with Reintegra is characteristic of current trade policy. "There is a somewhat aimless activism that ends up being very pragmatic, because it is not committed to a central thesis: they walk

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HOW CONVERTIBLE IS THE REAL?

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THE CREATION OF A CREDIT LINE in local currencies between Brazil and China should have major backing from Brazilian exporters, according to José Tavares, Cindes director. The US$30 billion credit line could be signed in February, according to the press service of the Central Bank. Tavares says that the agreement would create "a more predictable environment for exporters, because the currency issue is the martyrdom of any company that has foreign trade activities. "

Tavares notes that the initiative with China was only possible due to the Brazilian government's efforts to make the currency more convertible, which he considers an important advance. It's something that has been happening since the Lula administration, with the unification of the foreign exchange market (2005) and the simplification of exchange rate legislation by former Central Bank Governor Henrique Meirelles. Convertibility is gaining strength under Governor Alexandre Tombini with the government's strategy of seeking exchange rate stability, Tavares says, noting that "Conditions have been created so that the real can become a regional currency. Now, we need to encourage more agreements, and other countries to adopt [the real] as a store of value."

During her visit to Russia last year, President Rousseff discussed the possibility of using the real and the ruble in bilateral trade. The creation of a fund in the currencies of the BRICS (Brazil, Russia, India, China, and South Africa) is another alternative being considered. IBRE's Lia Valls points out, however, that the expanded use of local currencies in Brazilian trade transactions depends on the stability of the currency of the other country—she recalls that a similar arrangement between Brazil and Argentina in 2008 was short-lived. Roberto Gianneti da Fonseca Fiesp, notes that although using local currencies reduces the cost of financial transactions, there is a need to ensure compensation mechanisms, so that currencies can be spent beyond the borders of the two parties to the agreement.

Failure to reform Mercosur creates two problems for its members: It does not enhance the competitiveness of their industries and it stiffens negotiations of trade agreements.

through trial and error, making corrections along the way, discarding what did not work," he says, citing the strategies of protecting domestic production that have affected imports. Tavares argues, however, that the exchange rate issue implies an important institutional advancement about which little is said: "The Central Bank has been modernizing legislation to make the real a convertible currency, which could have a major effect on trade, as in the case of the agreement to swap local currencies being negotiated with China."

This trend, according to Tavares, extends to international politics, especially in South America, the main destination for Brazilian manufacturing. Tavares feels strongly that to promote regional integration it is necessary to have a rational institutional framework. Otherwise, trade is very dependent on the economic and political humors in various markets. In the case of Venezuela, where Brazil has built up one of its biggest trade surpluses, this year sales will be influenced not only by the price of oil, Venezuela's main source of export revenues, but also by the uncertainty about the health of President Hugo Chávez, because government buys most of what Brazil sells there. On the other hand, in the case of Argentina, the good prospects for its soybean crop may reduce import controls, which would create scope for that market to recover after the 20% drop in Brazilian exports to Argentina in 2012.

Failure to reform Mercosur creates two problems for its members:

BRAZIL'S MAIN TRADING PARTNERS
Brazilian exports in 2012

	Share in total exports (%)	Change 2012/2011 (%)
China	17.0	-7.0
United States	11.0	3.5
Argentina	7.4	-20.8
Holland	6.2	10.3
Japan	3.3	-16.0
Germany	3.0	-19.5
India	2.3	74.2
Venezuela	2.1	10.1
Chile	1.9	-15.1
Italy	1.9	-15.8

Source: Ministry of Development, Industry and Trade (MDIC).

it does not enhance the competitiveness of their industries and it stiffens negotiations of trade agreements. "Mercosur turned inward, while Chile, Peru, Colombia, and Mexico—which already have trade agreements with countries like Japan, China and the United States—have opened markets and integration possibilities. The dream of South American integration is becoming increasingly remote," de Castro says.

For Tavares of Cindes, Mercosur will only turn around if the common external tariff (CET) is abolished, making Mercosur a free trade area. He explains that "The CET is part of an old integration system and has zero economic sense today, because the CET tariffs aim at regional import substitution, which is not our problem. Our problem is how to ensure that our industries are able to compete internationally with rational industrial policies that respond to the difficulties industry is experiencing today."

Tavares argues that Brazil's trade policy bias of protecting domestic production is actually not good for industry. "Unlike other Mercosur countries, and other emerging economies like China and India," he says, "Brazil insists on taxing capital goods and intermediates, undermining the competitiveness of Brazilian products."

The result, for now, is a disincentive for companies to look beyond Brazil's borders. World Bank economist José Guilherme Reis notes that "One of the things that has attracted our attention is the low number of new firms entering the export market, the lowest among the 150 countries for which the World Bank collects information." According to the CNI, in the first half of last year, not only were there few new exporters but 352 companies stopped exporting.

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A World Bank report points out that the global economic crisis has highlighted the importance of diversification—for products, markets, and companies—to reduce the risks associated with higher volatility, greater specialization and the fragmentation of the global supply chain. Brazil, however, is a laggard in this area: While in the last 10 years, Brazilian exports rose from 10% of GDP in 2000 to 11.2% in 2010, China's went from 23.3% to 29.6%, and India's from 13.5% to 21.5%. From Reis's point of view, "Brazil is a global trader, exporting and importing from different countries of the world—but more as a traditional exporter than an exporter connected to the global supply chain . . . there are issues of competitiveness that need to be addressed." Brazilian foreign trade policy may need some re-thinking.

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