To trade or not to trade

Despite a laundry list of regional and subregional institutions, so far economic integration is at best only a tentative reality in Latin America. Trade agreements are vulnerable to a multitude of competing interests and the unpredictable ebb and flow of international trade.

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The Brazilian government announced last month that it would seek to renegotiate the automotive trade deal with Mexico. The decision has caused concerns that it may represent a shift toward a more protectionist stance, especially considering last year's decision to raise taxes on imported cars and auto production for automakers that do not meet a 65% local content requirement.

The main reason for the decision to review the trade deal with Mexico is that since the last review of the accord in 2009, bilateral trade flows have become significantly unfavorable to Brazil. From the time the automotive deal was signed in 2002 until the 2009 renegotiation Brazil had sustained trade surpluses with Mexico. Since then, Brazil has logged consistent deficits with Mexico—they reached $1.2 billion in 2011. Automobiles and auto parts account for about 45% of Brazil's total imports from Mexico.

For Brazil, two issues stand out. First is the local and regional content requirement of cars imported from Mexico. The floor today is 35%, but Brazilian officials want to apply at least the 45% level that is required from the Mercosur bloc (Mercosur countries and Mexico are exempt from the 65% requirement on auto imports from the rest of the world). The second issue is that Brazil wants to bring trucks and SUVs into the deal. If Mexico accepts the expanded coverage, in theory that might make trade flows more balanced, or even tip the automotive trade balance slightly in Brazil's favor.

The noise the renegotiation has generated may be a result of the timing of the announcement: Last September the Brazilian government increased the tax on auto imports for companies that did not meet a 65% local content requirement. With this as background, the renegotiation with Mexico might be seen as one more surge of

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a protectionist wave. Faced with increasing pressure from importers and potential investors, however, the government had to profess that the intention behind the measure was to stimulate local auto supply industries, not discourage foreign investors. In fact, Brazil recently issued a list of 18 automakers that will be exempt from the tax hike.

These measures, however, are unlikely to be extended arbitrarily to other sectors—that would definitely represent a more protectionist shift in trade policy. Rather, any new measures will likely target specific sectors and be driven by concerns about specific industries. For example, there has been mounting pressure from the local textile industry and the capital goods sector, both of which have been affected by growing imports. Moreover, the government will probably have to take a pragmatic line because it must balance the desire to protect sectors with attracting foreign investment and maintaining good relations with trading partners.

Nevertheless, Brazil's recent decision to review its deal with Mexico highlights the distance between the harsher constraints on local industries and the country's ambitious rhetoric about economic integration. High taxes and labor costs and the well-known infrastructure bottlenecks greatly reduce the competitiveness of Brazilian companies as imports from Asia keep growing. The problem does not affect just Brazil's relations with Mexico. Seeking to raise revenues while protecting its local industry, Argentina recently implemented a set of restrictions on its trading partners; and the main one affected is Brazil. Clearly, trade agreements between the largest economies in the region are vulnerable to a multitude of competing interests and the unpredictable ebbs and flows of international trade.

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Despite a laundry list of regional and subregional institutions and agreements, economic integration in Latin America is at best still only a tentative reality. And without broad economic reforms to increase competitiveness and constant political coordination by the leading economies, economic integration in the region is unlikely to move beyond the tentative.