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Federal Government of Brazil

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TRADE POLICIES IN BRAZIL

Helson C. Braga*
William G. Tyler*

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ABSTRACT

This paper provides a descriptive assessment of Brazilian trade policies, with emphasis on the import regime. Import policies in Brazil during the post-war period have consisted basically of the use of tariff and non-tariff barriers to restrict external competition and, in doing so, promote the installation of an ample and diversified industrial sector. As a result of high levels of domestic protection, low levels of competitive pressures, and limited size of the domestic market, the country presents a highly concentrated industrial structure with low levels of productivity efficiency. To improve efficiency is the main challenge for the future of trade policies.

I. INTRODUCTION

Despite significant economic and export growth during the past 40 years, Brazil remains a remarkably closed economy. Only a handful of countries (including Mozambique, Somalia, Bangladesh, and India) possess a lower percentage of GDP accounted for by exports than Brazil (9% in 1987). Trade and other incentive policies have been, in great part, responsible for the closed nature of the Brazilian economy¹. In addition to possessing a significant anti-export bias, these policies have, over the years, severed the link operating in most market economies between international and domestic prices operating through exchange rates and indirect taxes. The result of these policies has generally been the stimulate import substitution, suppress export activity, promote industry at the expense of agriculture, generate inefficiencies, permit domestic market power abuses, and discriminate against unskilled labor and Brazil's poor.² While it can be argued that the incentive policies of the 1950s, 1960s and early 1970s helped foster the development of a diversified and reasonably competitive industrial sector, incentive policies in the 1980s seem to have exacerbated Brazil's economic problems.

This paper provides a descriptive assessment of Brazilian trade policies, with an emphasis on the import regime. It must be stressed that these policies constitute only a subset of the overall constellation of economic policies comprising the incentive system. Other measures - not treated here - are equally important in affecting relative prices, costs and profitabilities. These policy instruments include domestic production subsidies, fiscal incentives, price controls, production and investment licensing requirements, etc. While all of these policies sometimes work at cross purposes, their net effect seems to have complemented, especially in the last 10 years, trade policies in their deterrent effects on import competition, export rivalry, and overall productivity growth.

¹For discussion of these and related estimate see Tyler (1985) and Braga et al. (1988).

²In addition to the work done in other countries on the effects of such policies, there is an ample body of literature dealing specifically with Brazil. See *inter-alia*: Bergsman (1970, 1972); Braga (1988); Braga and Hickman (1988); Braga et al. (1988); Coes (1988); Fasano et al. (1987); Tyler (1976, 1981, 1985); World Bank (1989a, 1989b).

II. OVERVIEW OF TRADE POLICIES, 1950-85

Several characteristics of the overall trade policy system stand out from 1950 to the present. They are: (a) the system's general stability over time (other than for the short-lived and cautious trade liberalization episode from 1967 to 1973);³ (b) a consistent anti-export bias in policies; (c) high tariffs; (d) an extensive and discretionarily applied tariff exemption, or reduction, system; (e) widespread, diverse, and restrictive non-tariff barriers to imports; (f) an export incentive system, beginning in the mid-1960s, designed to partially offset to anti-export biases in trade policies for potential and actual exporters; and (g) an overall lack of transparency and a high degree of discretionary decision-making.

A) The 1950-64 Period: Inward-Looking and Restrictive Policies

Trade policies in the 1950s and early 1960s provided a strong impetus to import substituting industrial activities. In the early fifties a multiple exchange rate system was used not only to ration scarce foreign exchange but also to provide protection for a variety of import-competing industrial activities. In 1957 a newly designed tariff system was introduced, and, with a few modifications (e.g., 1967, 1984, and 1989), it is largely this tariff system that exists to this day. The system has generally functioned, even recently, with high, and frequently prohibitive, tariffs coupled with tariff exemptions or reductions for favored activities. During the 1950s three institutions were established, which were to evolve to current importance in the formulation and implementation of trade policies. The Tariff Council (CPA) was founded in 1957 to administer the newly instituted tariff system and approve changes in it. With multiple exchange rates, import restrictions, and an emphasis on national "similarity" in production, an agency within the Banco do Brasil was established to administer the concomitant controls over trade flows. This agency - CACEX - has evolved into a central institution in the current trade policy regime, formally charged with the administration of trade policy but in fact exercising an important policy-making role as well. Also

³This not to say that there have not been a number of marginal changes, i.e., changes in the various policy instruments comprising the system, as opposed to alterations in the overall nature or thrust of the trade regime.



established during the 1950s was the Council of Industrial Development (CDI), which was charged with administering a fiscal incentive system (mostly tariff exemptions and reductions) for approved import-substituting projects.

The effect of the inward-looking trade policies pursued during the 1950-64 period was to allocate investible resources at the margin to import-substituting activities, continuing a process that had been ongoing during the 1930s and 1940s. By the mid-1960s inward-looking industrialization had reached an advanced state. By 1964 the aggregate ratio of manufacturing imports to total available domestic manufacturing supply had been compressed to .06; only in a few industries (notably machinery and chemicals) was the comparable ratio greater than 10 percent, indicating quite limited further scope for import-substituting led to industrial growth.⁴

B) 1965-1973: Cautions Outward-Looking Trade Policy Liberalization

In part reflecting policy-makers' perceptions of the limitations to further rapid growth based upon import-substituting industrialization, a number of policy innovations were introduced over a period of several years. These measures include: (a) exchange rate policy changes; (b) the introduction of various export incentives; and (c) import regime policy liberalization.

Policy emphasis was placed upon a "realistic exchange rate", with nominal devaluations occurring periodically and designed to maintain stable levels in the real exchange rate. In 1968 a "mini-devaluation", or crawling peg, exchange rate policy was implemented, which had the effect of reducing fluctuations in the real exchange rate.

Complementing the liberalized exchange rate regime, the Government introduced a number of export incentives designed to reduce the anti-export bias of existing trade policies. These measures included export tax exemptions and fiscal export subsidies for manufactures, export credit for production and sales, and a drawback system exempting exporters from import taxes on imported inputs.

⁴Tyler (1976), p. 68.

Import regime liberalization took place in two ways. First, import tariffs, which then carried the major weight of the protection system, were gradually and haltingly lowered. The average legal tariff for manufacturing, including surcharges, in 1966 was 99 percent (Table 1). Following a partially reversed attempt to substantially cut tariff levels in 1967, average manufacturing tariffs were reduced gradually to 57 percent by November 1973 (Table 1). Second, accompanying the general downward easing of tariff levels was a liberalization and increase of the tariff exemptions granted to importers under government industrial incentive programs. In particular, there was a relaxation of the interpretation of domestic production "similarity" (to be discussed below). Especially favored under the tariff exemption schemes were imports of machinery and other capital goods. Reflecting the increased importance of the various tariff exemption programs, the average realized tariff rate, i.e., actual tariff collections divided by total imports, fell from 12 percent in 1969 to 7 percent in 1974.⁵ The effect of this cautious trade policy liberalization characterizing the 1965-74 period was to reduce the policy bias against export production, especially of industrial products, and to increase the real remuneration for exporters. Partly reflecting this improved policy environment, exports increased markedly. Total Brazilian exports, measured in constant US dollars, grew by 13 percent annually from 1964-1974, with industrialized and primary product exports growing by 25 and 8 percent, respectively.⁶ Perhaps not coincidentally, Brazil during this period enjoyed its highest experienced rates of economic growth.

⁵Tyler (1980), p.37.

⁶Tyler, *ibid.*, p.17. An econometric exercise using Brazilian data and providing evidence of a responsiveness of export performance to changes in anti-export biases in trade policies is contained in Tyler (1984).

Table 1
Average Legal Tariff Rates 1/, Selected Years, 1966-1989
(%)

Industry	1966	1973	1980	1984	1989	
					Tariffs	Tariffs Surcharges 2/
Mining	27	22	27.0	16.7	19.5	24.8
Non-metallic minerals	79	52	107.5	98.7	37.7	44.8
Metallurgy	54	40	54.3	72.8	41.4	46.7
Machinery	48	38	56.3	62.1	46.9	51.6
Electrical equipment	114	56	99.1	100.4	50.2	54.5
Transportation equipment	108	43	101.9	115.9	47.3	52.2
Lumber and wood	45	66	125.3	101.1	28.9	32.9
Furniture	132	76	148.2	169.9	38.9	44.9
Paper	93	49	120.2	82.2	32.8	37.2
Rubber	101	65	107.3	101.7	58.6	64.4
Leather	108	73	156.6	135.2	44.6	51.1
Chemicals	53	22	50.3	34.2	37.0	42.3
Pharmaceutical products	48	21	27.9	42.2	40.7	43.4
Perfumery	192	48	160.5	184.4	73.6	76.5
Plastics	122	44	203.8	164.3	56.9	61.7
Textiles	181	91	167.3	161.6	77.9	84.0
Apparel	226	106	181.2	192.2	78.3	82.1
Food products	82	73	107.8	84.2	38.4	42.9
Beverages	205	131	179.0	183.3	70.5	78.4
Tobacco	193	141	184.6	204.7	85.0	88.8
Printing and publishing	122	35	85.5	71.1	27.8	34.1
Miscellaneous	104	42	87.0	136.5	54.4	60.2
Averages 3/						
Agriculture	53	34	53.8	57.3	24.0	29.0
Manufacturing	99	57	99.4	90.0	46.1	51.2

Notes: 1/ Includes surcharges, unless otherwise noted.
2/ Includes AFRMM taxes and CACEX surcharges.
3/ Value added weights are used.

Sources: Column 1 : Bergaman (1970)
Column 2 : Tyler (1976)
Column 3 : Tyler (1985)
Column 4 : Braga, et al. (1988)
Column 5-6: Authors' estimates, as developed from AGENCO, A Tarifa Aduaneira Brasileira (São Paulo, August 1989). Import surcharges estimates were based upon those presented in Kume (1989).

C) 1974-1980: Retrenchment and Renewed Inward-Looking Policies

The pendulum of trade policy liberalization, however, was about to swing back the other way, where it has since remained. In response to the balance of payments pressures associated with the first petroleum price shock, exchange rate adjustment was avoided through external debt accumulation and the increase of import restrictions. Tariff levels, including surcharges, were increased sharply during the mid-70s, rising from a manufacturing average of 57 percent in 1973 to 99 percent in 1980. As shown in Table 1, all output categories experienced tariff increases.

In addition, a number of non-tariff barriers to imports were either introduced or significantly expanded. A system of advance deposits for imports was established, as was a system of direct controls on import purchases by public sector enterprises. CACEX also made it more difficult to obtain import licenses. In addition, there was a tightening up in the granting of tariff exemptions and reductions under industrial incentive programs. For example, the number of CDI approved projects, involving tariff exonerations, fell from a high of 2,851 in 1973 to 130 in 1979.⁷

Further limiting tariff exemptions was an increasing rigidity in the interpretation of "national similarity". After import authorization under a tariff exemption scheme, the proposed imports were, and still are, nevertheless subjected to an examination of "national similarity". According to the so-called Law of the National Similar, a project can not receive benefits under the incentive system unless the imports carried out under the project have no comparable domestically produced counterpart. The examination for "national similarity" is the responsibility of CACEX, providing to that institution considerable discretionary authority. As a part of the tightening up of the "national similarity" requirements and to reduce some importer uncertainty about eventual CACEX decisions, National Participation Agreements (Acordos de Participação Nacional) were instituted in the mid-1970s. Typically, these Agreements have resulted in the imposition of local content requirements; the percentage share of capital goods imported under Participation Agreements (as opposed to purchased domestically) fell from 47%

⁷CDI, annual reports as reported in Tyler (1981), p. 42.

in 1973 to less than 18% in 1979.⁸

During this period it was also observed significantly increased protection for domestic intermediate and capital goods industries. Beginning in 1975 a major government effort was initiated to provide import substitutes in the capital goods and intermediate products industries. This effort in many instances involved the establishment of public sector enterprises, many of which have subsequently turned out to be inefficient producers. In addition to the provision of massive credits to those selected industries at highly subsidized interest rates, direct import controls were frequently applied, along with more traditional (in Brazil) restrictive trade practices.

All of these measures had the effect of increasing import restrictions and the protection of domestic production from import competition. Since there was no appreciable change in the export incentives during the 1974-80 period, the profitability of production for the domestic market increased relative to that for exports.

In December 1979 the Government announced a series of economic policy measures, designed to reduce policy-induced distortions and provide a greater reliance on market signals. A maxi-devaluation of the cruzeiro was announced, reducing its value by 30 percent and temporarily breaking with the crawling peg exchange rate regime. At the same time, the fiscal tax credit subsidies for manufacturing exports and the import deposit scheme were eliminated. Accordingly, the devaluation was compensated by partially offsetting trade policy measures. Steps were also announced to do away with tariff exemptions and rebates, indicating an intention to move away from a highly discretionary system for awarding such incentives. This attempt at liberalization proved short-lived, however, as the economic crisis of the 1980s unfolded for Brazil.

D) 1980-1985: Economic Crisis and Further Retrenchment

The Government basically tried to deal with the adverse shocks imposed by the second petroleum price crisis and the accentuated increase in

⁸Tyler (1981), p. 45.

international interest rates in the same way that it had dealt with the first petroleum crisis - by increased international borrowing and tightened import restrictions. While the possibilities for expanded borrowing quickly were exhausted and, then with the oncoming debt crisis, reversed, the import policy regimes was not so constrained and as such was further tightened. With the necessity to provide heavy debt service under conditions of limited access to financial markets, the need to generate trade surpluses was apparent. The resulting significant trade surpluses have been generated through restrictive demand management, some expenditure switching (in 1983-4), and accentuated import controls and restrictions. Since legal tariffs were already largely prohibitive, additional import restrictions had to take the form of further increasing quantitative restrictions, tightening import licensing requirements, and diminishing the coverage provided by tariff exemptions.

Four major innovations in restrictive import practices were introduced in the early 1980s. First, outright and extensive import prohibitions were implemented, albeit in the form of "temporary suspensions" for issuing import licenses by CACEX. Second, import financing requirements were established, varying for the type of good and the size of the transaction. Third, foreign exchange controls, exercised by the Central Bank, were instituted with the acute foreign exchange shortage in 1982-3. Fourth, a system of "Import Programs" was developed whereby individual importing firms would annually negotiate their yearly import levels with CACEX. These four restrictive instruments have evolved as central elements in the highly restrictive, nontransparent, and discretionary trade policy regime that prevails currently in Brazil.

III. CURRENT TRADE POLICIES

A) Exchange Rate Policies

Although exchange rate policy has continued with its basic objective of maintaining the purchasing power of the national currency in relation with the US dollar, the difficulties experienced by the Brazilian economy since the external crisis of 1982 have brought several changes in the rules of exchange rate management by the Government. These changes have been reflected

in oscillations in the real exchange rate (Table 2). As a result, the real protection afforded by the trade policy regime, especially as depicted by the tariff system, has been subject to some fluctuations. This is also evident, as observed in Table 2, if analyzed from the perspective of fluctuations in the real effective exchange rate, taking into consideration movements in exchange rates among Brazil's major trading partners.

B) Tariff Policies

The tariff system has evolved as summarized in Table 1. There was a liberalizing tariff reform implemented in July 1988. This reform eliminated some import surcharges (a 25% foreign exchange operations tax (the IOF) applied to import transactions and a 3% surcharge for port improvements), simplified and consolidated the import tax regimes, reduced legal tariff rates (lowering the maximum rate to 85%) but left largely untouched the more important system of non-tariff barriers. The average tariff rates as of August 1989 are presented in Column 5 of Table 1. In addition to the legal tariff rates, there remain two significant import surcharges. They include: (a) a surcharge amounting to 50% of freight costs (earmarked to benefit domestic ship-building and shipping); and (b) a 1% flat surcharge imposed by CACEX for the issuance of the necessary import licence (guia de importação). The tariff rate plus the estimated import surcharge are presented in Column 6 of Table 1.

As observed, the mean tariff rates prevailing in Brazil in August 1989, despite their reduction, remained quite high by international standards, with the average for manufacturing, including surcharges, estimated at 51%. For some industries the tariffs plus surcharges amount to rates in excess of 75% (e.g., textiles, apparel, beverages and tobacco). Interestingly enough, these are industries where Brazil's revealed comparative advantage is frequently very high. Tariff redundancy is widespread; average nominal protection, as measured through direct domestic and international price comparisons, has been considerably lower than the levels of protection afforded by tariffs and import surcharges (Table 5).

Table 2

Indexes of Real Exchange Rate and Real Effective Exchange Rates: 1983/88
(1980 = 100)

Year	Index of Real Exchange Rate		Index of Real Effective	
	(Cz\$/US\$)	1/	Exchange Rate	2/
1983	121.6		100.0	
1984	125.3		98.0	
1985	128.3		99.5	
1986	127.5		119.1	
1987	120.8		122.2	
1988	104.3		107.7	

1/ Simple average monthly rates (of sales) computed on the basis of the number of working days during the month; deflators: Brazil - Wholesale Price Index; and Wholesale Price Index (IFS, line 63a).

2/ Refers to the following currencies: Dollar, Yen, Mark, Franc, Pound and Guilder; simple average monthly rates (of sales) computed on the basis of the number of working days during the month; deflators: Brazil - Wholesale Price Index; USA and France - Wholesale Price Index (IFS, line 63a); other countries - Wholesale Price Index (IFS, line 63).

Source: Centro de Estudos Monetários e de Economia Internacional/Instituto Brasileiro de Economia (IBRE)/Fundação Getúlio Vargas (FGV).

In general, tariffs and import surcharges are not the binding, central instruments in providing protection to domestic production. Tariff exemptions are significant and imports are more effectively controlled by non-tariff barriers. Despite the high formal legal protection of tariffs and surcharges, tariff reduction schemes erode protection and reduce tariff collections. While the number of special import tax regimes was reduced with the 1988 tariff reform measures, tariff reductions or exemptions remain for drawback imports (destined for use as intermediate inputs for export production), regional investment programs (for the Northeast and Amazon areas), government institutions and state owned firms, the Manaus Free Zone, privileged sectoral investment programs (e.g., informatics), investment projects for exports as approved by the BEFIEX program, and air transportation. Under many of these arrangements, particularly for investment projects, the award of tariff exemptions or reductions is highly discretionary. Because of the various

tariff reduction schemes, in 1987 the average realized tariff (import tax revenue collections divided by total imports) was only 11%.

C) Explicit Non-Tariff Barriers

As noted above, non-tariff barriers are more important than tariffs in providing protection and restricting access to the domestic market. Brazil's non-tariff barriers can be classified in two categories - explicit and implicit non-tariff barriers, with the latter being the more compelling as well as less transparent. Explicit non-tariff barriers currently consist of: (a) temporary import suspensions; (b) restricted imports for which prior authorization by a specific sectoral government institution is required; and (c) import financing requirements. Two other explicit non-tariff barriers (minimum import values and reference prices) have been recently eliminated and are being replaced by other, GATT consistent, measures to deal with dumping and unfair trade practices.

The temporary import suspensions are in effect prohibitions, and in their application they are not seen to be temporary. Although the coverage of the list ("Anexo C") of prohibited imports (formally products for which CACEX has indicated that it will not issue an import licence) has varied over time, the list itself has existed since the early 1980s, with many products being consistently banned. Nearly all of the prohibited products are produced in Brazil; many are considered "superfluous". The import prohibitions as of August 1989 are summarized in Table 3. Out of a total of 11,987 positions in the Brazilian tariff code, import prohibitions exist for 1,831, or 15.3% of the total. Consumer goods are the most subjected to import prohibitions, with 36% of all tariff code items not allowable for importation. The import prohibition coverage ratios are particularly high for tobacco (100%), apparel (83%), and furniture (68%).

In addition to outright prohibitions, some imports are also formally restricted on an individual product basis. These restrictions are applied, in addition to the overall restrictions imposed by CACEX, by government institutions or agencies having a particular interest in given products. Of particular interest are computer and electronic products, which are subject to authorization for import by the Special Informatics Secretariat

Table 3

Explicit Non-Tariff Barriers, 1989

Industry	No. of Tariff Positions	Positions Subject to Restrictions (%) of Tariff Positions		
		Prohibited	Other Restrictions	Total Restrictions
Mining	174	0.0	1.1	1.1
Non-metallic minerals	331	8.5	0.0	8.5
Ceramic products	36	38.9	0.0	38.9
Glass	134	10.5	0.0	10.5
Other Non-metallic mineral products	161	0.0	0.0	0.0
Basic Metal	620	1.1	26.3	27.4
Iron and Steel	341	0.0	37.0	37.0
Non-ferrous industry	279	2.5	13.3	15.8
Metal product nec.	672	20.4	18.3	38.7
Non-electric machinery	1276	5.1	4.9	10.0
Electrical Machinery	617	21.6	9.2	30.8
Transport Equipment	354	33.1	0.0	33.1
Wood products	194	3.6	0.0	3.6
Furniture	37	67.6	0.0	67.6
Paper	199	14.1	0.0	14.1
Rubber	93	10.8	0.0	10.8
Leather	110	36.4	0.0	36.4
Chemicals	2276	0.4	1.9	2.3
Pharmaceuticals	773	0.4	1.8	2.2
Plastics	143	6.3	0.0	6.3
Textiles	1030	43.0	0.0	43.0
Apparel	188	83.3	0.0	83.3
Food Products	896	9.7	0.0	9.7
Beverages	126	15.1	0.0	15.1
Tobacco	15	100.0	0.0	100.0
Printing and Publishing	65	27.7	0.0	27.7
Other Manufacturing	588	49.3	0.0	49.3
Averages 1/				
Agriculture	477	9.0	5.0	14.0
Manufacturing	11336	15.8	6.0	21.8
Consumer Goods	3764	36.3	0.7	37.0
Intermediate Goods	5038	4.6	7.5	12.1
Capital Goods	2434	7.5	11.0	18.5
WHOLE ECONOMY	11987 2/	15.3	5.9	21.2

Notes : 1/ Unweighted Averages.

2/ Aggregated data. Total Positions = 12443.

Source: Computed from AGENCO, A Tarifa Aduaneira Brasileira, (São Paulo: August, 1989).

(SEI), which in turn has pursued a restrictive market reserve policy to protect and promote domestic production. SEI has been strict in granting import permissions and has systematically sought to expand its authority to prohibit imports of a wide variety of products containing chips or other electronic components. Also included under the special prior authorizations are imports domestic production. In the event of a shortfall in internal output, imports are allowed. Particularly important in this category of products are agricultural commodities. Included also, however, among those products for which special prior authorizations are required for imports, area number of metal products; imports of these goods are subjected primarily to the permission of the National Steel Council (CONSIDER).

Summing the prohibitions and the special prior authorization restrictions, coverage of a total of 21.2% of the country's tariff positions is apparent (Table 3). For manufacturing the coverage amounts to 21.8% of the relevant tariff positions.⁹ A lower bound, production weighted average for manufacturing, calculated at the two digit level, indicated that 22.5% percent of production was protected by these two explicit non-tariff barriers.

Begun in the early 1980s as a response to the balance of payments crisis triggered by the cessation of voluntary commercial bank lending, external financing requirements for imports requiring foreign exchange cover have been employed. They have varied in intensity and coverage. In late 1979 the importation on consumer and intermediate goods in excess of US\$ 200,00 annually required import financing of 180 days and one year respectively. For capital goods imports the external financing requirements have been more strict, going up to five years for imports of more than US\$ 1 million. Since external financing is highly constrained, with trade financing being unavailable to all but the more established and larger firms, the external financing requirements have constituted an important constraint on importing.

⁹A somewhat comparable estimate of coverage for the manufacturing sector for 1984 is 55.6% (See Guimarães, Carvalho and D'Althouguia (1987)). In 1984 the list of suspended imports (Anexo C) was significantly reduced.

D) Implicit Non-Tariff Barriers

In addition to the explicit non-tariff barriers indicated above, there exist a number of less tangible, but highly significant, non-tariff barriers. Although these instruments defy quantification, there is a consensus among analysts of Brazilian trade policies that they are indeed binding instruments of control for imports. They include: (a) state monopolies (covering the imports of mainly petroleum and wheat); (b) exclusion of official investment credit and credit benefits for imported capital goods; (c) individual firm import programs; and (d) the so-called Law of National Similarity, which prohibits the granting of any fiscal benefits for products not produced domestically.

The system of import programs reflects an elaborate foreign exchange allocation system.¹⁰ The import programs system created in 1980 has evolved into a complex system of direct foreign exchange and import controls. This system is at the very heart of Brazil's restrictive trade policy system. It currently operates with an annual foreign exchange budget being prepared by the Central Bank, with allocations being made for debt service, drawback and other privileged imports, and general imports. For general imports, importing firms must have an annual import program negotiated with and approved by CACEX. The amount of approved imports constitutes the firm's import entitlement for the year, and the import program is necessary for the subsequent issuance of an import licence by CACEX. The import program also establishes a chronology for the firm's annual imports. In the process of negotiating an import program the contents of the firm's proposed annual imports are scrutinized as well as the amounts. In addition to the constraints imposed by the overall foreign exchange resource envelope, the criteria for negotiating the import programs have included the index of nationalization of the firm's products (i.e., domestic content requirements), share of the firm's output exported, and the trade balance of the firm (i.e., an implicit cross-subsidization of exports).

¹⁰A good description is contained in World Bank (July 1989).

The so-called Law of National Similarity specifies that fiscal benefits, namely exemption or reduction of taxes, can only be obtained for imported goods not produced domestically, i.e., not having a "national similar". To reduce the uncertainty of having an import licence denied or having to pay heavy penalties, firms frequently negotiate a National Participation Agreement (Acordo de Participação Nacional). The purpose of these agreements, negotiated jointly by the firm, CACEX and the relevant domestic producers' association(s), is to specify in advance which products do not have a national similar and can therefore be imported with fiscal benefits. In principle, there are no restrictions to importing products with a national similar, provided that the importing firm is disposed to pay the corresponding taxes. Inasmuch, however, as tariff rates are very, and even prohibitively, high (despite recent efforts to reduce those rates), firms normally seek recourse to the extensive and diversified import tax exemption/reduction schemes for privileged imports.

E) Export Incentives and Promotion

Fiscal and credit incentives for exports have exercised an important role in the growth of Brazilian manufactured exports since the mid-1960s. In 1978 the sum of these incentives represented nearly 60% of the value of manufactured exports, with 35% consisting of subsidies. Since then, the magnitude of these incentives has been progressively reduced to an average of 40% and 10%, respectively, for the 1985-87 period (Table 4).

In order to take into account the combined effect of the export incentives, changes in the real effective exchange rate, and fluctuations in export prices, Bontempo (1989) constructed an index of remuneration for manufacturing exports. The estimated index shows that real remuneration demonstrated little annual fluctuation during the 1976-88 period, reflecting exchange rate depreciation generally compensating the reduction of export subsidies between 1978 and 1984.

One important export incentive dating back to the early 1960s has been the so-called drawback system. The drawback, administered haltingly during the last 25 years, allows duty-free imports of intermediate destined for

export production. In doing so, it establishes a free trade regime for direct export production, enabling the exporter to freely purchase inputs at international prices. It currently operates outside the annual import programs and on a fairly automatic basic with minimal administrative restrictions. Most analysts agree that the drawback has been an important factor in expanding Brazilian manufactured exports.

Table 4

Fiscal Incentives and Export Credits
(in % of Manufactured Exports)

Year	Fiscal Exemptions 1/	Subsidies			Total
		Fiscal Subsidies 2/	Fiscal Subsidies 3/	Subtotal	
	(A)	(B)	(C)	(D)=(B+C)	(E)=(A+D)
1978	24.9	22.1	12.4	34.5	59.4
1978/82	27.5	13.0	14.8	27.8	55.3
1983	27.6	11.3	11.4	22.7	50.3
1984	27.9	10.5	3.8	14.3	42.2
1985	28.4	7.7	2.4	10.1	38.5
1986	30.5	6.7	2.9	9.6	40.1
1987	29.4	6.2	4.2	10.4	39.8

- 1/ Refers to the drawback and the rebates of taxes for merchandise circulation (ICM).
 2/ Refers to the exemption of income taxation and to the export subsidy from the industrial product and circulation taxes.
 3/ Measures the net disbursement of the Central Bank and the Federal Government with the export financing.

Source: Bontempo (1989).

In addition to these generalized incentives, manufacturing exports can also benefit from an additional, more selective set of incentives. These are the BEFIEX incentives. Created in 1972, the BEFIEX Program provides, on a discretionary and negotiated basis, fiscal incentives for the import of machinery and inputs in exchange for a commitment on the part of the benefitted firm to undertake an agreed amount of exports for a 5-10 year period. The rationale of the program is to permit the modernization of the

participating firms, reducing their costs and increasing their competitiveness in domestic as well as international markets.

In 1988 at the occasion of the tariff reform and the announcement of changes in industrial policies, the BEFIEEX Program was considered an integral part of the Government's industrial policies. At the same time, some steps were introduced to broaden the program's benefits and make more agile the implementation of the program, especially for projects located in the North and Northeast. Between 1972 and 1985, 317 projects were approved; in 1986 the exports associated with such projects accounted for some 40% of manufacturing exports.¹¹

Also in 1988, the Government implemented legislation permitting the creation of Export Processing Zones (EPZs) in the North and Northeastern regions. The Government so far has authorized the installation of 10 EPZs, a number which it considers the maximum. These EPZs are currently in the process of being established, although slowly under existing conditions of resource scarcity and restrictive legislation.

IV. THE APPLICATION OF TRADE POLICIES

A) Tariffs

The Tariff Commission (Comissão de Política Aduaneira, or CPA) is the government agency charged with the administration of tariff policy. The CPA secretariat has the authority to reduce tariffs for goods considered to be "basic" products, primary goods and raw materials, and food products. The CPA can also change the tariff rates for any product provided that those changes are approved by the plenary commission. This commission - or CPA itself - is an inter-ministerial body with representatives from other government agencies as well as from the private sector. During the 1980-86 period approximately 1,800 products had their tariff rates changed, with about 90% of those

¹¹Data reported and analyzed by Baumann (1989).

experiencing decreases in tariffs.¹² Until mid-1988 petitions for tariff rates could be sent directly to CPA from interested firms, producers' association, or other government agencies. These petitions were analyzed by the CPA technical secretariat and decided upon by the plenary commission. The results were disseminated in the form of CPA Resolutions. Beginning in mid-1988 CPA has insisted that petitions for tariff rate changes be presented entirely by producers' associations, thereby eliminating the possibility of tailor-made tariff changes to benefit individual firms.

Since the tariff reform in mid-1988, the CPA has implemented two fairly comprehensive tariff reductions, both with the principal objective of reducing the excessive tariff redundancy that has characterized the tariff system. It does not appear, however, that there is a trade liberalizing objective in these actions. The negotiations and discussions of these reductions, as well as the tariff reform of mid-1988, have taken place in a tranquil and harmonious fashion - an unlikely situation if an actual reduction of protection was at issue.

In addition, the discretionary nature of the present incentive system make real tariff from and trade liberalization more difficult. Current industrial policies of the Government have as a principal instrument the concession of facilities to import machinery and equipment for priority projects and sectors on a selective basis. As a result, the relative importance of these incentives is greater, the higher the import tax rates. From the viewpoint of the authorities administering the highly discretionary system of import tariff exemption/reductions, there is a natural predilection to resist reductions in tariff barriers.

B) Non-Tariff Barriers

In the final analysis, all non-tariff barriers are applied by CACEX, which is charged with issuing the universally applied import licence. Depending, however, on the type of product being imported, other government agencies are also given a say. Although CACEX officials generally minimize

¹²See Baumann (1988).

the organization's role, alleging - rather inaccurately - that CACEX merely administers policy made elsewhere, CACEX possesses and exercises enormous, and frequently discretionary, powers over the flow of Brazil's international trade.

Formally, CACEX is merely a directorate of the state-controlled Banco do Brasil. Yet, its powers and influence go far beyond what would appear from its hierarchical and institutional structure. While officially subservient to the Banco do Brasil's president, CACEX's director is appointed by the President of the Republic. Although the individual is expected to work closely with the Minister of Finance, his own influence within CACEX is somewhat circumscribed by his inability to appoint or retain any individuals who are not career Banco do Brasil employees. As a result, in the last 10 years directors who are not CACEX career employees have felt their powers within CACEX frequently quite limited in the face of institutional intransigence, despite outside support among the top economic policy-makers.

In addition to presiding over the country's trade information, CACEX possesses the overall responsibility of regulating Brazil's foreign trade. Over the years it has developed a comprehensive control apparatus. The centerpiece of its empire of administrative controls is the power it exercises over imports. In its actions it routinely dispenses quasi-rents. In October 1989, for example, the premium of the parallel exchange rate over the official one was about 80%, signifying a substantial benefit to those receiving the ability to purchase foreign exchange at the official rate, as is the case with the award of an import licence. The system essentially begs abuse, and it is not surprising that complaints in the private sector are rife. Aside from considerations of the distribution of quasi-rents, the overall rationale explaining CACEX's actions is one of trying to minimize net foreign exchange expenditures and to provide protection to national production.

C) Dispute Settlement: Anti-Dumping and Countervailing Duties

In 1987 Brazil implemented the GATT Subsidies and Anti-Dumping Codes, which had been signed, but not implemented, in 1979. Prior to implementation, unfair trade practices on the part of Brazil's trading partners were handled

with two highly restrictive mechanisms - the minimum import value (pauta de valor mínimo) and import reference prices. Both of these mechanisms were contrary to the norms accepted by the GATT and generated continuing conflict for Brazil in international commercial fora. These practices were as a result eliminated. It is CPA's responsibility to administer the GATT Subsidies and Anti-Dumping Codes, as well as to define the internal procedures for their implementation. What is observed, however, is that the existence of severe import controls maintained by the Government has rendered domestic production relatively immune to unfair international trade practices. With the implementation of the new legislation in 1987 there has been but one case of an anti-dumping legal action. The cases of products most likely to be subject to unfair trade practices have simply been resolved by including those products on the list for which imports are prohibited, i.e., "Anexo C".

V. SOME EFFECTS OF TRADE POLICIES

Import policies in Brazil during the post-war period have consisted basically of the use of tariff and non-tariff barriers to restrict external competition and, in doing so, promote the development of a diversified industrial sector. The active direct participation of the state in a number of sectors has complemented the general, import-substituting industrialization strategy during the period.

For its part, the policy of export promotion implemented in the mid-1960s consisted fundamentally of a set of measures intended to offset the anti-export bias in economic policies associated with the structure of protection afforded to production for the domestic market. Since that protective policy apparatus has remained in place, development has been largely inward-directed and autarchic in nature. As a result, Brazil produces nearly everything the country consumes.

Table 5 presents a picture of the combined effect of the various trade and other incentive policies. On the basis of domestic and international price comparisons, implicit tariffs and effective protection rates have been estimated for 1980/1 and 1985. The extent to which domestic prices differ

from international prices constitutes a measure of the effect of policy induced distortions. As seen in Table 5, those distortions have been considerable.

The observed high levels of domestic market protection, the low levels of competitive pressures, and the limited size of the domestic market have contributed to a highly concentrated industrial structure with low levels of productive efficiency. The structure of protection has favored capital and discriminated against unskilled labor - the effect of which has been to aggravate the distribution of income. In addition, the high levels of industrial concentration have also contributed to the misallocation of economic resources and to the slow growth of productivity in the economy.¹³ The low levels of productive efficiency in turn undermine international competitiveness and restrict the country's ability to grow.

¹³For a treatment of this question see Braga and Mascolo (1982).

Table 5

Implicit Nominal Protection and Effective
Protection Estimates, 2 Digit Level, 1980/81 and 1985
(%)

<u>Industry</u>	<u>Average Implicit Nominal Protection</u>		<u>Effective Protection Rate Estimates</u>	
	<u>1980/1</u>	<u>1985</u>	<u>1980/1</u>	<u>1985</u>
Mining	-3.6	-6.2	-4.2	-10.7
Non-metallic minerals	-17.7	12.0	-19.6	10.3
Metallurgy	10.8	26.6	34.2	53.0
Machinery	58.7	11.8	93.3	5.6
Electrical equipment	81.7	47.0	129.3	54.7
Transportation equipment	-3.7	12.4	-6.5	-4.4
Lumber and wood	-4.3	20.9	17.7	39.1
Furniture	26.1	46.0	52.7	53.1
Paper	-16.1	18.6	-18.5	44.1
Rubber	-15.4	45.6	-21.4	43.3
Leather	15.6	33.6	13.9	29.0
Chemicals	55.1	22.9	86.4	63.2
Pharmaceutical products	97.4	99.5	116.3	117.8
Perfumery	35.1	23.4	91.6	26.3
Plastics	28.9	114.8	28.3	189.0
Textiles	25.2	65.1	36.7	112.1
Apparel	30.6	111.7	46.7	231.4
Food products	-8.2	-6.8	26.1	45.8
Beverages	-5.3	3.0	-1.1	-1.7
Tobacco	1.3	-70.7	5.7	-79.6
Printing and publishing	24.1	-0.9	31.9	-5.3
Miscellaneous	91.8	75.6	171.7	96.7
Averages				
Agriculture	-7.2	-23.2	-8.2	-24.6
Manufacturing	24.5	18.0	46.4	42.9

Sources: 1980/81 estimates, Tyler (1985)
1985, et al, Braga (1988)

VI. THE FUTURE OF TRADE POLICIES

In mid-1988 The Government announced what has been termed the "New Industrial Policy". It represents an extension of existing policies and consists basically in the granting of fiscal incentives (exemption/reductions) for the import of machinery and inputs for special integrated sectoral investment programs, programs for technological industrial development, and BEFLEX programs for promoting exports. In addition, there was a tariff reform, as discussed above, which was mainly intended to reduce redundancy in tariff rates. In general, the "New Industrial Policy" is designed to distribute benefits in a discretionary and preferential fashion to seemingly arbitrarily selected sectors and projects. It is inconceivable that this strategy will meet the challenge of increasing the economy's competitiveness and promoting technological progress. A viable strategy must be based on something more solid than merely permitting the preferential, selective, and spasmodic importation for foreign machinery and equipment.

A strategy to increase competitiveness, technological progress, and growth would necessarily involve the introduction of greater competitive pressures to force improved efficiency. Among other things, such a strategy would involve a liberalization of trade policies, including: (a) the reduction (elimination) of non-tariff barriers; (b) the phase-out of tariff exemptions (except for export production); (c) a generalized and phased tariff reform, reducing rates and establishing uniform tariff levels; and (d) the conduct of exchange rate policy consistent with progress in trade policy reform. While the proponents of trade policy liberalization seem to be gathering strength in Brazil, as elsewhere, the immediate outlook for proceeding with such an approach is very uncertain.

The question of macroeconomic equilibrium and stability is paramount, and ultimately it is macroeconomic policies and circumstances which condition the pursuit of trade policies and circumscribe the government's ability to proceed with trade policy reforms. At the same time, macroeconomic crisis presents a unique opportunity to proceed with politically difficult reforms. Whether the newly elected Brazilian Government will be able to take advantage of this opportunity to reform trade policies and establish a stronger base for future economic growth remains to be seen.

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