Geo Factsheet

Number 136

Brazil - Changing Pattern of Trade: LEDC to NIC

Glossary

Economic diversification - The broadening of the economic base across all four sectors.

NIC - A country which has experienced rapid and successful industrialisation in recent years – note there is an official World Bank list of designated NICS which is updated annually.

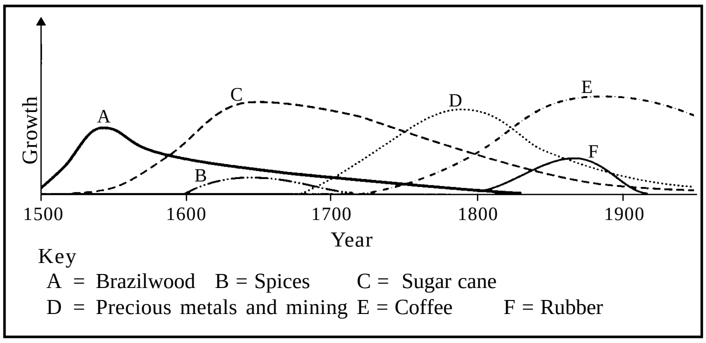
Protectionism - The institution of policies which protect a country's manufacturing industries from competition from cheap imports – usually during early years of development.

Venture capital – Capital that is raised for high risk developments e.g. in R & D or biotechnology.

Introduction

Brazil's economic history has been influenced to a considerable extent by foreign trade trends and policies. Successive cycles of export booms in commodities such as sugar, gold and diamonds, rubber, and coffee played significant roles in Brazilian development before World War II *(Fig 1)*.

Fig 1. Brazilian development before World War II

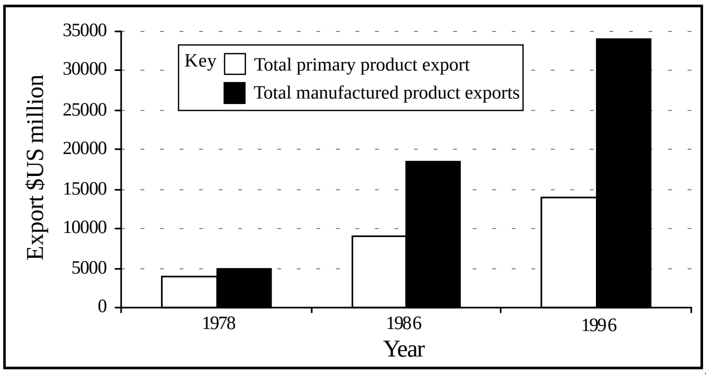


- after World War II, industrial development was fostered through restrictive trade policies. These controlled the amount of imports to protect Brazil's own industries, making Brazil a relatively closed economy by the mid-1960s.
- Only in the early 1990s did significant trade liberalisation occur, as Brazil joined Mercosur (Common Market of the Southern Cone).

Changing Trade

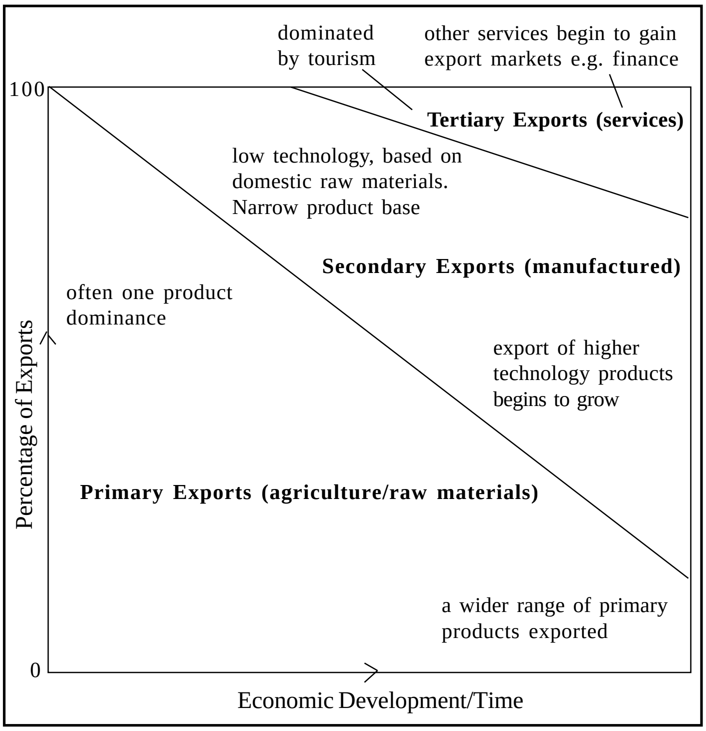
As Brazil has undergone **economic diversification** to achieve the status of a Newly Industrialised Country [NIC], its pattern of trade has changed significantly. As *Fig 2* shows, the balance between the exports of the primary and secondary sectors has shifted very firmly in favour of the latter.

Fig 2. Brazilian exports of primary products & manufactured goods



Such changes correspond well to *Fig 3*, a model of the changing pattern of exports in LEDCs, which can be applied to most developing countries of a significant size. Only forty years ago, nearly 80% of Brazil's exports by value came from three crops – coffee, cotton and cocoa, all of which could fail from bad weather or disease.

Fig 3. Model of changing pattern of exports in LEDCs



***Exam Hint** - Try to devise a similar diagram for changes in Brazil's imports.*

Current Trade Analysis

1. Major trading partners

The United States is Brazil's major trading partner *(Table 1)*, although in relative terms the relationship is not as strong as it once was. For example, in 1960 over half of Brazilian exports went to the USA.

Table 1. Brazil: top ten trading partners 2000

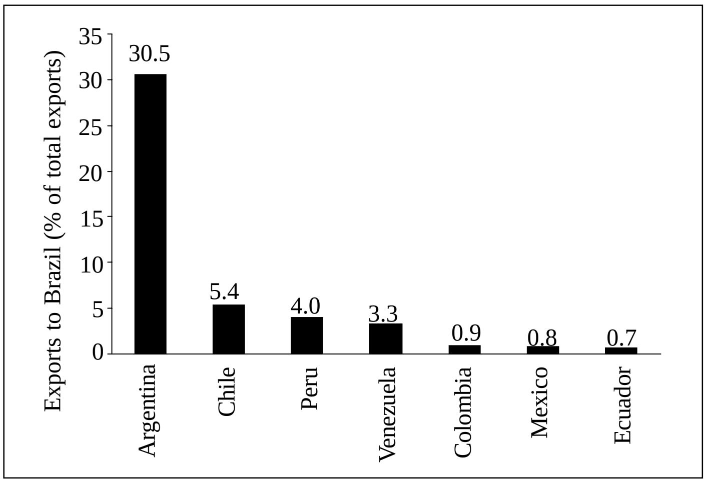
Exports ($ Billion)		Imports ($ Billion)	
1 USA	13.2	1 USA	12.9
2 Argentina	6.2	2 Argentina	6.8
3 Netherlands	2.8	3 Germany	4.4
4 Germany	2.5	4 Japan	3.0
5 Japan	2.5	5 Italy	2.2
6 Italy	2.1	6 France	1.9
7 Belgium-Luxembourg	1.9	7 Algeria	1.9
8 France	1.7	8 South Korea	1.4
9 Mexico	1.7	9 Venezuela	1.3
10 UK	1.5	10 UK	1.2
Total (including others)	55.1	Total (including others)	55.8

Argentina is clearly in second place but thereafter the differences between the rest of Brazil's top ten trading partners are less significant. The UK is in tenth position for both imports and exports.

Brazilian trade flows to neighbouring Latin American countries are weak even after six years of Mercosur. Until relatively recently, Brazilian exports to the rest of South America had averaged less than 10% of all exports. This is a result of:

- the relatively strong inward orientation of many of Brazil's Latin American trade partners during most of the early post-World War 2 decades. Import-substitution policies were designed to protect domestic industries from foreign competition. Thus, the more open economies of North America and Europe continued to provide the most important markets for Brazilian exports. Conversely, Brazil is a relatively small market for many of its Latin American neighbours *(Fig 4)*.

Fig 4. Exports to Brazil from Latin American neighbours



- The historical domination of exports by primary and semi-processed products. The major markets for all these products were mainly in high-income countries. For example, Brazil long depended on the USA as its major market for coffee. Other important primary products, such as soybeans, sugar and iron ore, were also sold mainly to high-income countries.

Table 2 shows Brazil's major exports and imports for the year 2000.

Exam Hint *- when analysing a table comment on general picture (balance of trade overall), then details of exports and imports.*

2. Primary product exports

Brazil is a major exporter of foodstuffs. With its great size and climatic diversity it is able to produce a wide variety of agricultural products ranging from tropical products in the north to temperate foods in the south. However, farm products account for a much smaller share of Brazil's exports today than they used to. In 1978 the export of manufactured goods exceeded primary products for the first time. Coffee, for instance, accounted for no less than 70% of total exports in the 1920s. Today it amounts to about 3%. In fact, coffee is now Brazil's second-ranking farm export after soybeans and soy meal *(see table 2)*. Orange juice concentrate ranks third, tobacco (leaves) fourth and sugar fifth.

Brazil trails only the USA in the production of soya with yields above the world average but 6.5% behind those achieved in the USA. The soya boom began in the 1970s. The leading states of Rio Grande do Sul, Mato Grosso and Parana account for about two-thirds of production.

The expanding global market for soya has made it a popular crop in agricultural frontier areas such as Amazonas. Brazil is the world's largest sugar producer and is easily the most important exporter.

Brazil has been anxious to reap the best rewards possible from its agricultural exports. For example, together with the other members of the Association of Coffee Producing Countries, set up in 1994, Brazil agreed to several measures designed to support international prices. Brazil, along with other developing countries, is concerned about the high level of agricultural subsidies provided to farmers in North America, the European Union and Japan. Such subsidies protect farmers in these world regions, making it more difficult for developing nations to export their farm products to the developed world.

Brazil produces and exports a wide range of minerals. The foreign trade balance for minerals is usually in deficit although if petroleum and gas are excluded from the total, there would be a surplus. Imports are significant in the national energy balance:
- Brazil imports almost 50% of its oil - much of it from Saudi Arabia
- Coal is imported from the United States and Australia
- Electricity imports come mainly from Paraguay's share of production from the giant Itaipu HEP plant which straddles the boundary between Paraguay and Brazil
- Natural gas is imported from Bolivia.

Indeed, to solve its energy gap, Brazil has even started producing fuel for cars from its surplus sugar cane.

With regard to its trade in energy, Brazil is most concerned about increases in the price of oil which can have a significant impact on the economy. Oil price rises affect Brazil in two significant ways.
(a) they pressure the trade deficit in that Brazil needs to export even more to keep the value of its imports and exports in balance.
(b) because transportation is a cost factor in all industries, they push up a range of other prices leading to inflation.

As *Table 2* shows, iron ore dominates the export trade in minerals. Exports account for about three-quarters of Brazil's total production of this mineral. Most of the deposits are found in the states of Minas Gerais and Para. With its huge forest resources it is not surprising that wood pulp also ranks in the top ten list of exports.

Table 2. Brazil: Top 10 exports and imports 2000 (by value in $ Billion)

Exports	
Aircraft	3.1
Iron Ore and Concentrates	3.0
Soya (including powder)	2.2
Passenger Vehicles	1.8
Soya (Bran)	1.7
Transmitting and Receiving Equipment	1.6
Footwear	1.6
Chemical Wood Pulp	1.6
Coffee	1.6
Parts for Cars and Tractors	1.2
Total for Top 10	**19.4**
Imports	
Naphtha (a petroleum product)	1.9
Telecommunications Equipment and Parts	1.4
Fuel Oils	1.3
Medical and Veterinary Supplies	1.3
Heterocyclics, Salts and Sulphonamides	0.9
Wheat	0.9
Potassium Chloride	0.6
Coal	0.5
Aircraft	0.4
Cotton (raw)	0.3
Total for Top 10	**9.5**

3. The Growth of Manufacturing and Service Exports

Following World War II industrialisation accelerated. In 1958 Brazil replaced Argentina as the leading industrial nation in Latin America, a position the country still holds. Brazil's largest single exporter is Embraer, the aeronautics company. As the world's fourth largest aircraft manufacturer, Embraer clocked up $2.5 billion worth of exports in the year 2000. After aircraft, Brazil's largest secondary sector export is motor vehicles *(Table 2)*. Foreign car companies such as Volkswagen frequently see Brazil as a springboard for other markets in South America. Of Brazil's traditional manufacturing industries, footwear remains the largest exporter. To remain competitive in a very crowded market, much of the footwear industry has relocated from the Southeast to the Northeast to take advantage of lower wage costs.

Services now account for more than 10% of Brazil's exports and this percentage is expected to increase. Tourism is important, but is as yet relatively undeveloped in an international sense. It is only in the last few years that Brazil has become a package tour destination. In recent years the government has done much to encourage tourism, seeing the industry as a major potential source of foreign currency. The country is so diverse that it has enormous potential for tourism.

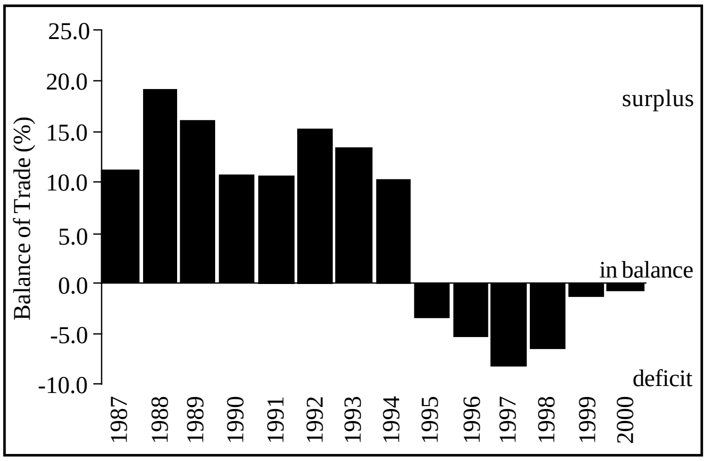
Further research: obtain a series of far away long haul brochures and with the aid of a map of Brazil record the range and occurrences of package routes

However, Brazil's tertiary export base goes beyond tourism. For example, Brazil is the world's biggest exporter of television programmes. Also Brazilian engineering companies participate in projects in a number of other countries by providing consultancy. As the service sector comes to employ more and more people its contribution to exports will undoubtedly grow. These changes reflect Brazils growth from LEDC to NIC.

4. The balance of trade

After several years of large trade deficits, Brazil found itself near equilibrium in 1999 and 2000 *(Fig 5)*. Sales of imported goods declined as the value of the national currency [the real] tumbled against the dollar. It is currently estimated that Brazil will enjoy a trade surplus over the next four years.

Fig 5. Brazil: The balance of trade 1987 - 2000



Although Brazil's export portfolio is more diverse than twenty years ago, its export base is small for the size of its economy. Brazil's share in world exports has fallen from 1.5% in the late 1980s to 0.8% in the late 1990s. Brazil's low export base makes it particularly vulnerable to economic fluctuations. The two main external risks are possible negative events in the US and Argentina, Brazil's major trading partners.

Brazil's past export success was due in part to subsidies, which masked underlying problems. One reason for its present modest trade situation is that primary products, such as iron ore, coffee and soya, still account for a significant share of Brazil's exports. Such primary products have become less important in world trade and their prices are currently depressed. Another reason is that Brazil is poorly represented in high-technology products, an area in which world trade has grown particularly rapidly. Most of Brazil's exports derive from a relatively small number of large firms, the majority of them foreign-owned. In 1997, fewer than 500 firms accounted for 80% of industrial exports, with almost half of this total emanating from local branches of multinationals. In general, multinationals export more than Brazilian-owned firms. However, the volume of such multinational exports is not as much as from their operations in other countries.

Traditionally, multinationals have set up in Brazil to supply its huge domestic market. With a population of almost 170 million, the size of Brazil's consumer base is 70% greater than that of second-place Mexico, and more than four times that of third place Colombia. However, in recent years there have been signs of change, with more and more foreign companies starting to use Brazil as a base to supply the whole of Latin America. Brazil-based multinationals' exports to Latin America amounted to 47% of their total exports in 1997, up from 26% in 1990.

The performance of Brazilian firms in the export market has been held back by four factors in particular:

- **Protectionism by MEDCs**. The Brazilian government estimate that this factor alone costs the country at least $6 billion a year in lost exports.
- **Poor overseas marketing**. The relatively rich pickings to be had in Brazil's large domestic market has resulted in a lack of ambition among many firms to export.
- **The 'Brazil cost'**. This is a term used by business people to describe a range of factors, such as poor infrastructure and government red-tape, which they say handicap their ability to compete in international markets. Portuguese is the official language and this is a minority global language when compared to Spanish and English.
- T**he high cost and general difficulty of obtaining credit**. This is a particular problem for small and medium-sized enterprises. To quote a recent report in the Economist, "Venture capital in Brazil is almost unobtainable, and working capital unaffordable, with bank loans for small businesses costing 50-90% a year in real terms".

Protectionism by MEDCs

The role of Mercosur

Brazil is a key member of Mercosur. This is a customs-union established on January 1st 1995, which joined Brazil, Argentina, Paraguay and Uruguay in a single market of over 200 million people. Mercosur accounts for 50% of Latin American GDP, 43% of its population, 59% of its total area, and 50% of its industrial production. In theory it is a full customs union, with a common external tariff and free trade inside it. In fact there are hundreds of national exceptions to this, but the aim was for such national tariffs to be brought into line in 2001.

Common external tariff

Mercosur did not appear overnight but was the culmination of trading agreements which had grown steadily stronger in the preceding years. It began with a mid-1980s deal between Argentina and Brazil and took its present shape in 1991. Since then it has been cutting internal tariffs on an agreed schedule with the objective of creating a full customs union and, in time, free movement of labour and capital.

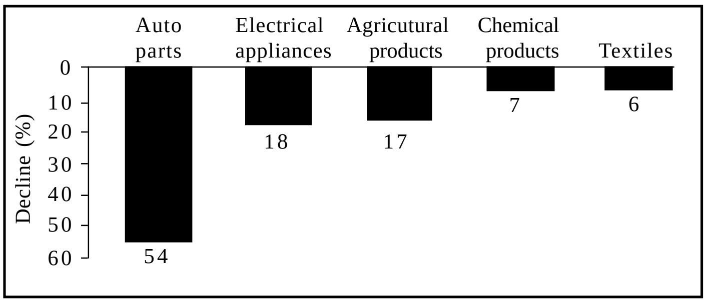
Mercosur is the first stage in a much wider proposed economic relationship. Mercosur is negotiating with the Andean Pact countries [Bolivia, Peru, Ecuador, Colombia and Venezuela] and Chile for the creation of a Latin American Free Trade Area [LAFTA]. This is seen as an important building block towards the establishment of the American Free Trade Area [AFTA] by the year 2005. Brazil's President Cardoso has demanded that the USA and Canada "have to pay" for a hemispheric deal by opening up to their countries' Brazilian exports. United States tariffs on 15 of Brazil's main exports are at a rate of 45.5%.

The 1998-2000 Mercosur 'Trade War'

After a considerable increase in trade between Mercosur countries, relations between Mercosur's largest members, Brazil and Argentina, turned sour in 1998. Mercosur was at its best when trade between these two key nations was balanced. However, the flow of trade moved heavily in Argentina's favour from 1995.

The dispute involved several crucial sectors of both economies, including agriculture, automobile and clothing manufacturing. When the Brazilian economy took a nosedive in 1998 the government took various measures in an attempt to rectify the situation. One response was to erect unilateral trade barriers that proved harmful to other Mercosur members. Relative to 1998, trade between Mercosur nations declined 26% in 1999 *(Fig 6)*.

Fig 6. Brazil's exports to Argentina



However, Brazil achieved a trade surplus with its Mercosur partners in 1999, the first since 1995. Until mid-2000, the disruption of commerce between Brazil and Argentina cast doubt on the viability of Mercosur as a trade bloc. Brazil represents a very important source of foreign sales for other Mercosur nations. The level of Brazilian imports started to drop in the latter half of 1998 and the decline persisted into early 2000. The result was regional economic decline accompanied by rising unemployment. Declining economic activity in one of the bloc's largest economies can result in even greater decline in the smaller economies. The Mercosur summit held in June 2000 in Buenos Aires sought to solve these problems and to bring Mercosur back on line.

In conclusion

Trade is highly volatile and very competitive, and a whole range of issues can 'blow up' as shown below.

- In a longstanding dispute, Brazil and Canada have accused each other of providing illegal export subsidies to their regional aircraft makers, which are fighting bitterly for their share of the rapidly growing market. Recently the Brazilian aircraft manufacturer Embraer lost out to the Canadian firm Bombardier when the latter announced a $1.7 billion contract to sell 75 regional jets to the US airline Air Wisconsin. In a highly controversial move, the Canadian government provided Air Wisconsin with up to $1.1 billion in low-interest loans to help seal the deal.

- In 2000 the World Trade Organisation [WTO] gave Canada permission to impose $1.4 billion worth of trade sanctions on Brazilian products after the trade group determined Brazil had not brought its subsidies into line with WTO rules.

- Brazil has claimed the right to produce cheaper medicines if foreign pharmaceutical companies who hold the patents do not do it. President Cardoso has argued, "We cannot accept being penalised for the fact we are competitive. The position of Brazil is not belligerent but calm and firm."

- In February 2001, the US and Canada lifted a 21-day ban on Brazilian beef imports after concluding that Brazilian cattle are grass fed, do not eat animal protein and do not pose a risk of spreading mad cow disease. One of the conditions imposed by the US and Canada is that Brazil must certify that the animals are grass-fed.

As Brazil developed into a NIC its trade has increased but not to the extent of other very large countries or NICs. In terms of exports, it has become more diverse and less dependent on primary products but is still very vulnerable to both internal and world events.

Practice Exam Questions

For an LEDC you have studied:

(a) Explain why foreign trade is important to this country. [5 marks]

(b) To what extent and why has the pattern of its trade changed over time? [20 marks]

Guidelines for answers

(a) Some of the goods and services that individuals, companies and various levels of government require in Brazil can only be obtained from abroad. For other goods and services, buyers want to compare the quality and price of Brazilian products with those of other countries. Where foreign goods and services are perceived to be better value, Brazilians will buy from abroad unless their government places obstacles [e.g. tariffs, quotas and regulations] in the way of such trade.

Brazil needs to export for two main reasons. First, it needs to pay for the goods and services it imports. It earns the foreign currency required by selling those of its products which are in demand in other countries. Second, Brazil holds a considerable foreign debt which it is gradually paying off from its export earnings.

(b) *Fig 3*, a model of LEDC export change, provides a useful framework for this part of the question. The model could be discussed using Brazil as an example. For instance, only 40 years ago 80% of Brazil's exports came from primary products. Today, such products account for less than 25% of total exports. At one time coffee dominated both primary exports and total exports. Much of Brazil's early industrial investment came from the profits made from the export of coffee. Once a number of key industries reached a certain size, protected by import-substitution policies, export markets were sought so that production could be expanded even further. The government was anxious for this to happen for the reasons stated in part (a). *Fig 2* shows the increasing share of total exports accounted for by manufactured goods in recent decades. Multinational companies have played an important role in this transformation. Higher technology goods, cars and aircraft in particular, are accounting for an increasing share of Brazil's exports. The attraction of Brazil to multinational companies should be explained. However, as yet Brazil has not had a significant impact on the information technology market, although the Government sees this as a priority area for the future.

The service sector is now beginning to play a more important role in exports. Tourism is important in this sector but the potential remains for the industry to expand rapidly in the future. However, Brazil's service sector is not dominated by tourism as industries such as television programmes and engineering are significant exporters.

Further Research

Institute of Latin American Studies University of London
www.sas.ac.uk/ilas
World Bank www.worldbank.org
World Trade Organisation. www.wto.org
World Trade Organisation Watch -USA www.wtowtch.org
-excellent source of critical information on World Trade Organisation

UNCTAD United Nations Committe on Trade and Development
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