Protectionism or self-defense?

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The North-American Government, in a letter sent by the U.S. Trade Representative Ron Kirk to the Brazilian Foreign Minister, Antônio Patriota, accused Dilma Government of being “protectionist”, for having decided to raise tariffs on one hundred products imported by Brazil. And he urged the Brazilian Government to reconsider its decision. The Brazilian Minister made an ironic comment on the U.S. Trade Representative for having “recognized the legality” of the Brazilian measures within WTO, and asserted that Brazil was forced to take this initiative because the quantitative easing policy implemented by the United States has lead to an appreciation of the Brazilian real.

Patriota has also accused the United States of subsidizing its agriculture, but the news in terms of tariff discussion is to demonstrate that tariffs and exchange rate mutually replace each other, as far as import is concerned. This is a “forbidden” thesis at WTO, but it is obvious, after all. If a country increases by 10% its average tariffs, whereas the exchange rate appreciates by 30% at the same time, in practice the domestic manufacturing industry was left unprotected in 23% with regard to the initial price in Brazilian reais. Let’s do the maths, starting from a zero tariff, of the price of a good costing US$10.00, and an exchange rate of R$2.60 per dollar, entailing a price in reais of R$26.00. If a tariff of 10% is imposed, its price in reais will be R$28.60; but if the exchange rate appreciates by 30%, dropping to US$1.82, the price in reais will drop from R$28.60 to R$20.00, in such a way that the additional protection of 10% turned into a net unprotection of 23%, due to the depreciation.

This substitution of exchange rate in place of tariff and the thesis that the exchange rate left free tends to be chronically overvalued in developing countries are in the core of the new Keynesian-Structuralist school, which is emerging in Brazil around the new developmentism. When Minister Guido Mantega, who is part of this school, stated a few years ago that Brazil was being the victim of a currency war, he was thinking in these terms.

Obviously the United States and the club of the rich countries named West do not agree, because they ideologically believe that the general trade liberalization suits their interests. In fact, with respect to the countries with average income that are able to export manufactured goods, it is no longer true. If these countries manage to neutralize the two causes of this chronic exchange rate overvaluation (the excessive capital inflows, now worsened by the quantitative easing policy of the rich countries, and the Dutch disease), they will profit more than the rich countries with the trade opening.

This was realized a long time ago by the dynamic Asian countries, which were not deceived by the thesis of the West that they “need” their capital. We Brazilians have also already started to understand this fact, but haven’t had enough strength to implement it yet, either because the dependence of our elites and mainly of our economists is much greater than that of the Asian elites, or because the Dutch disease is more serious here than over there. As we have not succeeded in setting the exchange rate at the true balance level, we are compelled to raise tariffs. It is a second best, but it is evident that the Brazilian Government will not be impressed by the American protests and accusations. What Brazil is doing is self-defense.