Brazil’s Quest for Comparative Advantage

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***Does Brazil’s comparative advantage lie in agriculture or manufacturing?***

A pine tree in a forest in Finland needs 50 years before it can be felled to make paper. A eucalyptus tree in coastal Brazil is ready in seven. Grapes in France can only be harvested once a year. Grapevines in northeastern Brazil can bear fruit twice a year. Chicken and hog farmers in Canada have to consume energy to heat the barns. Their competitors in Brazil need no energy to heat their animals’ dwellings. Blessed by an abundant supply of sunshine, soil, and water, Brazil is a preeminent player in agricultural products such as beef, coffee, poultry, soybeans, and sugar—in which Brazil is either the world’s top producer, top exporter, or both. Brazil’s agricultural prowess may be the envy of many less well-endowed countries, but in Brazil this prowess has become a source of frustration. For much of the 20th century, the Brazilian government sought to deviate from Brazil’s dependence on agriculture-based commodities and to industrialize, often with little regard for comparative advantage. Their favorite policy was protectionism, which often did not succeed.

Brazil’s market opening since the 1990s led more Brazilians to realize that the country’s comparative advantage indeed lies in agriculture. One commodity that can potentially transform the low prestige associated with agricultural products is sugar cane-based ethanol. Brazil is a world leader in the production of ethanol, which has been mandated as an additive to gasoline used in cars since the 1970s. A system to distribute ethanol to gas stations, an oddity in the eyes of the rest of the world until recently, now looks like a national treasure that is the envy of the world. At present, no light vehicle in Brazil is allowed to run on pure gasoline. Since 2007, the mandatory blend for car fuels is at least 25% ethanol. Brazil currently produces 18 billion liters of ethanol, of which it exports four billion—more than half of worldwide exports. Ethanol now accounts for 40% for the fuel used by cars in Brazil. As the global ethanol trade is estimated to rise 25-fold by 2020, Brazil’s comparative advantage in agricultural products is destined to shine.

However, the government under President Dilma Rousseff continues to believe that Brazil has to build up a world-class manufacturing base in order to modernize its economy. Standing in the way is the (in)famous “Brazil cost,” thanks to the rising costs of energy, raw materials, wages, and taxes. Operating costs in Brazil are now higher than in many developed economies. One industry association official noted: “If you were to take a factory by helicopters from Germany to Brazil, your costs would jump 48% as soon as you touched down. Those of us producing in Brazil are doomed to be uncompetitive.”

The government does want to help by protecting uncompetitive industries. In this respect, Rousseff has not deviated from her days as a graduate student studying developmental economics with some of Brazil’s most left-wing professors. Since taking power in 2011, she has imposed tariffs on shoes, textiles, chemicals, and even Barbie dolls. Brazil also threatens to tear up an agreement with Mexico that allows free trade in cars, because in 2011 Mexico exported US$2 billion worth of cars to Brazil, but Brazil only reciprocated with US$372 million.

The “Brazil cost” has also been aggravated by the ups and downs of the real, which appreciated 38% against the dollar between 2009 and 2013. But in 2015 the real took a real hit, going from R$2.08 to US$1 in 2012 to R$2.31 to US$1 in March, reaching R$2.94 by midyear. Such fluctuation has made solid planning very difficult for manufacturers.

The phenomenal export success of Brazil’s agricultural products and minerals and the lackluster condition of its manufacturing industries can force Brazil to reassess its comparative advantage. One expert noted: “The economy needs to redirect resources to where it is competitive. That is actually a healthy process.” The catch, of course, is only if there is sufficient political will.