Determinants of the reform trajectories of Emerging Economies

The ambivalent influence of economic interests on the Emerging Economies' foreign trade policy

1. Domestic Politics to explain foreign economic policies

With his seminal edited volume "Between Power and Plenty", Peter Katzenstein established Domestic Politics as a theory to explain foreign economic policies as a result of "domestic structures". He submits that the conjured "dualism" between the state and society has been bridged since the middle of the nineteenth century in the advanced industrial states (Katzenstein 1978, 11). The distinction between the state and society can no longer be warranted as the former has been opened to societal pressures, which align the "national interest" with the public good, pursued by the actors at the helm of the state. Factors that might have contributed to this former gap was the staffing of bureaucracies with people of a particular class and a political system that denied the broad masses access to the decision making process.[1] Peter Gourevitch (1986) restricts and disciplines himself to explaining economic policies, whereas Katzenstein et al. (1978) had sought to explain economic outcomes, general foreign policies, as well as foreign economic policies. In his analysis of remedies applied by governments during global crises, such as the Depression of the 1930s and the Stagflation during the 1970s, Gourevitch (1986) cogently connects the influence of societal actors to policy outcomes. In his "political sociology", tracing domestic coalitions, Gourevitch uses the material interests of economic actors as his focal point. The broad masses are merely broached and seem to play a role only as "nonunionized labor", which can be manipulated and distracted with debates over nationalism, religion or race (Gourevitch 1986, 226). The necessary support of the masses at the ballot box and the risk of social unrest in the case of blatant collusion of the government with business leaders are therefore underestimated in this contribution. Katzenstein and Gourevitch are both "untainted" by economic theories, which would help to systematically identify affected interests, and fail to integrate the need for mass appeal in their Domestic Politics approaches. Contributions since the 1990s have enhanced the Domestic Politics approach, by either grounding it on economic theory or by making Ideas an explanatory variable in its own right.

The predictions of the Interest-based Explanations

The interest based strand has a lot to offer in that direction. The dissertation project will share the clearcut assumption that interests are not constrained or guided by ideologies. It will be assumed that economic actors, i.e. those with palatable economic interests with regards to the opening of the economy, will act rationally, seeking to maximize their utility (Frieden 1991, 16). Some authors argue that ideologies serve as prisms, through which business leaders perceive their policy alternatives

[1] As an example Katzenstein refers to a stylized Prussia, whose bureaucracy was "manned by members of the East Elbian gentry" and which had a political organization that denied the broader masses access to its political "mechanism" (Katzenstein 1978, 17).

(Gourevitch 1986, 32). In this dissertation project it will be argued that "interests" will lobby on a strictly material basis, without the need for an elaborate economic theory or ideology to steer the way.

The need to account for the industries' competitiveness

The seminal essay of the interest based approach by Frieden & Rogowski (1996, 36) proposes two trade theories from Economics, which bear relevance for the Domestic Politics approach. The Stolper-Samuelson theory and the specific factor model are according to Frieden & Rogowski apt to identify economic groups, which stand to benefit and which would be harmed from the liberalization of the economy. The Stolper-Samuelson approach is an extension of the assertion that a country will "tend to export goods intensive to the factor it has in abundance, and to import goods intensive in factors in which it is scarce" (Frieden & Rogowski 1996, 37). The Stolper-Samuelson approach spells out, which kind of wealth or income re-distribution can be expected in such a scenario. As the demand for goods, which employ the abundantly available factor rises, owners of this factor will benefit from rising income levels, since exports are propelled by freer trade. The products that used to be valuable, since their supply was curtailed by the lower availability of the required factors, however, are under competitive strain from imports, which crimps the income of the owners of the once scantly available factors. Rogowski (1989) contends that political cleavages will run between factor owners benefiting from trade, as they are abundantly available in a country, and those who will suffer relative income losses in the economy, because they used to be scarce in the state of protectionism. The "Specific Factors Model" allowed production factors to be permanently lashed to a certain sector (Krugman & Obstfeld 2003). The new model that emerged in the 1970s relaxed the assumption of perfect mobility of factors, which can be redeployed to other usages in the wink of an eye. The specificness of a factor impedes its mobility and depends on the time and costs it takes for it to be redeployed to other usages. The implications on how specific factors will position themselves vis-à-vis general economic policies have already been described by Frieden (1991). Regarding the efforts to promote freer trade, the theory establishes benefits arising to those factors invested in sectors that are competitive and achieve trade surpluses. Factors specific to sectors under pressure will on the other hand suffer and hence beset the government to refrain from lowering entry requirements. The theory is simply to show that each sector faces different competitive pressures, that the sectors will develop sector specific preferences and that a universal, monolithic capitalist interest is a simplification that cannot be sustained when looking at the glaring differences in the sector-specific policy preferences. The cleavages between interests are expected to arise between sectors that are buoyed by rising prices for their products, due to an expanded demand from the world markets, and flailing sectors which clamor for tariffs and investment restrictions as the influx of foreign products crimp their profits.

H1: The extent of the (un-)competitiveness of an industry in the world markets will determine whether or not it will lobby for protection or not.

The need to account for the dependence on the global value chain

Another crucial driving force of the industries' lobbying with regards to the government's foreign economic policies is the unwillingness of the domestic industries to tolerate the distortionary effects of protectionist interventions. This unwillingness is in marked contrast to the tolerance exhibited in the years of the import substitution models in both India and Brazil. While one can safely assume that the distortionary effects of protectionist interventions have remained the same over time, the aggrieved domestic industries are no longer placated by the government. In the past decades, the mollycoddled, protected industries were granted guaranteed prices. That means they could charge a guaranteed price that amounted to their incurred costs and a profit margin. In Brazil, the government formed an Interministerial Price Council (CIP), where the firms and industries were to submit their cost plans, to get approval for price increases. While this system was implemented to keep prices in check, its independence was increasingly corroded and politicized by the business interests (Kingstone 1999, 57). It degenerated into a self-service shop, when the assemblers were allowed to raise the prices before consulting the price council. The system had therefore essentially become one of "institutionalized markup pricing" in favor of the producers (Shapiro 1994, 201). In India, the government had for large parts of the economy introduced a cost-plus pricing system, which it could implement through the domination of the public sector in the economy and through controlling every investment, pricing and overseas trade decision by the remaining marginalized private companies. Since the Indian government determined the prices it allowed the companies to charge the cost of production and add a profit margin on top. This blunted the effects of the high-cost supplies on the companies that bought the expensive, locally sourced inputs. Through this pricing system each company's interest in lowering the input costs was significantly reduced. One plant manager of the telecom product manufacturer, ITI, described the situation as follows: "ITI was not bothered because Post & Telecommunication Service (P&T) paid all our costs; P&T was not bothered because it could go on increasing tariffs" (Subramanian 2011, 208). Hence many of the Indian companies could simply roll over the policy-induced inefficiencies, by charging higher prices from its customers, which were higher up in the value-chain.

As a consequence industrialists sturdily opposed reform attempts and rather lobbied for short-term subsidies, to make the domestic market more appealing, instead of building commercial ties with overseas suppliers or costumers. This had been one of the factors contributing to the sagging reform drive in the 1980s although smaller crises had been flaring up from time to time in both countries even before the 1990s crash (Bardhan 1984, 65). The reforms in the 1990s, however, did finally rid the economies of the planning system that had become defunct and had regressed to a mere entry barrier for up-coming enterprises and which had drained resources away to companies with better political ties. A more competitive environment makes sure that tacit reciprocal support between the state and the industries and politically potent conglomerates is hampered. A functioning market with a healthy dose of competition assures that the industries do not simply harvest the low hanging fruits in the

domestic country. Thus one can expect that first of all a debate will arise between the different firms and sectors and the tacit collusion is broken up and that each industry will have to strive to expand internationally and will try to remain competitive, as the competition has become unrelenting. This will increase the efficiency pressures on each industry and make them ardent supporters of freer markets.

H2: The industries' dependence on foreign supplies will shape their preferences for liberalizing the trade regime, thus pitting them against the interests of the sectors lobbying for protectionism.

2. Empirical Puzzle – Why has the trade channel remained open?

The opening of the economies in many emerging markets, such as in Brazil and India, who had built up a diversified industrial base in their respective economies, has put the manufacturing industries under enormous strains. The overall economic performance during the past decade that was buoyed by a commodity boom in Brazil and by a stellar economic performance of a few selected know-how intensive industry services in India masked the constant decline and even decay of the manufacturing industries in both countries. The next two sections shall discern the country-specific challenges of both countries' industries and show that they both faced and still face "hard times", which would usually lead to a relapse into protectionism (Gourevitch 1978).

2.1 The economic travails of the Emerging Economies' industries

The uncompetitiveness of India's industrial base

After the reforms in the 1990s, new Indian entrepreneurs entered the stage of the Indian economy. With the razing of the administrative barriers, which had thwarted new ventures in the past, they created entire home-grown economic sectors from scratch. Within two decades, they firmly established flourishing high-technology industries like the software and the pharmaceutical industry. The liberalization also unleashed the innovative capacity of incumbent companies. They adapted their business models, added new products to their production lines and managed to increase the overall output by an average of 200% (Goldberg et al. 2010, 175). The number of employees in India's IT and pharmaceutical sector has grown tremendously. Both are nowadays employing circa 900.000 and half a million, respectively (Arora 2008, 201). But these sums pale in comparison to the whole Indian labor force that is growing even more rapidly and is poised to attain 500 million in the next years (World Bank 2014). Most of the labor force finds itself in the unorganized sector, which means that they earn their livelihood through unlicensed, unregistered economic activities or that they are self-employed. Estimates by the Indian government suggest that over 90% of the Indian working-age population find themselves in this unorganized sector (Government of India 2012, 1). The share has roughly remained the same since the liberalization of the economy. Most of these jobs of the informal economy are found in the rural area. The failure to dent the share of those employed in the unorganized sector has

been attributed to the overall uncompetitiveness of India's manufacturing sector. India lacks an industrial middle, which would bridge the divide between the competitive high-technology sectors in bustling cities like Bangalore and those "trapped in relatively unproductive jobs in agriculture and menial service work" (*Wall Street Journal*, 13 April 2014). Anne O. Krueger (2013, 301) has therefore coined the term of a "missing middle" in India, by which she means the lack of a staunch, labor-intensive manufacturing sector that has been the mainstay of the development of most industrialized countries and most recently of many ascending East Asian countries, like China. The high labor costs, the dismal state of India's infrastructure, the lack of foreign investments and the ubiquitous regulations have effectively hampered the performance of India's labor-intensive sector. This can be readily gleaned from a short comparison with China's export performance. China has accumulated foreign exchange reserves worth $4 trillion. This has been achieved mainly by exporting manufacturing goods, as 93% of the exports were manufactured goods, while India has racked .

These Chinese figures eclipse the performance of the Indian economy. While the Chinese companies and the multinationals' subsidiaries are untrammeled by regulations and labor laws and subsequently trounced the Indian competitors, India seems "entirely divorced from global production chains in unskilled labor-intensive manufacturing" (Panagariya 2008, 33). This notion is true for India's electronics sector, where almost the entire demand in India is met through imported products, assembled in China or other developing countries. The Indian textile sector on the other hand has achieved increases in its exports. But its performance, like the rest of the labor-intensive industries in India, has been dampened by India's labor laws. This is why the much smaller countries, such as Bangladesh and Vietnam are now on par with India with regards to the exported volume of apparels.

The malaise of Brazil's industrial base

Since the days of the *Estado Novo*, initiated by Getúlio Vargas, the Brazilian government has pushed to industrialize the Brazilian economy. After a short hiatus, Juscelino Kubitschek continued to steer Brazil's economy into the same direction as Vargas. Under the flag of Developmentalism, successive Brazilian governments have implacably sought to replace the traditionally strong agribusiness sector with the manufacturing sector (Sikkink 1991, 40). To shed the alleged status of Brazil as a "semi colonial country" that still lingered in a state of "economic and cultural dependency on Europe and the US", the Brazilian government deliberately discriminated against Brazilian farmers and funneled the available resources and those expropriated from the agribusinesses to the nascent manufacturing sectors (Kubitschek cited in Bates (1997, 112). These redistributions were flanked by high custom duties on industrial goods, which promoted investments from domestic players and multinational corporations into Brazil, to circumvent these prohibitively high trade barriers (Schneider, Skidmore, Kohli). The strident opposition by the domestic farmers was to no avail (Bates 1997). Overall, the policies led to an increasing share of manufacturing activities in Brazil's GDP. This share peaked in the mid-1980s, when it contributed 35 per cent the Brazilian GDP (World Bank 2015). The razing of

the import barriers that were introduced as part of the *Plano Real*, to shore up the anti-inflationary measures introduced and completed by Itamar Franco and Fernando Henrique Cardoso, however put an end to the increasing share. Instead, the role of the manufacturing sector was increasingly chafed away. While the aggregate share had gradually declined to a mere 13 per cent of Brazil's GDP, the development of the trade (im-)balances for former protected industries shows to which extent the manufacturing industries have been clobbered by the global competition. There is nary an industrial sector that managed to churn out net exports. Some product segments, such as "nuclear reactors, boilers, machinery and mechanical appliances" and "electrical machinery and equipment and parts thereof" saw their net imports surge from each roughly $5 billion in 1996 to $22.8 billion and $23.5 billion respectively in 2013 (UN Comtrade 2015). The same decline in the industry's competitiveness has been witnessed by the country's fertilizer, chemicals, plastics and other technical industries. The bout in the commodity prices on the other hand has been a windfall for Brazil, as it spawned burgeoning business endeavors in the field of unprocessed soybeans and iron ore whose products were gobbled up by the Chinese market. Thus the opening of the economy generated a broad set of reform losers that had thrived under the import-substitution regime with its guaranteed prices and profit margins and have since withered, while at the same time it also bore winners in the relatively narrow mining and agricultural sectors. The trickle down effects by the commodity sectors towards other manufacturing sectors have so far been marginal. Even within the soybean complex, the processing units, the so called crushing industry, which processes the soy grains to get soybean oil and meal, is languishing and suffers from low capacity utilization and the cheaper competitors from abroad. The same goes for the boom in the iron ore mining industry. The abundantly available raw material has not helped the domestic steel industry.

2.2 The trajectory of the foreign economic policies in Brazil and India

The foreign economies policies by the emerging markets garner a lot of negative headlines because the governments have played an obstructive role on the multilateral WTO trade talks and because its bilateral trade agreements showcase that shallow agreements do not yield significant growth or trade impulses. The examples for the governments of the emerging economies, toppling the trade talks are myriad. India for instance effectively halted the agreement on the minimum consensus reached during the WTO trade talks. It stymied further progress because of an "ambiguous wording of a one-paragraph clause" on the subsidies for food. Brazil's government has also played an ambiguous role in the multilateral agreement (*Financial Times*, 16 November 2014). Moreover, both countries have so far failed to conclude substantial bilateral trade agreements. While Brazil has used the difficulty of obtaining a compromise for a common trade strategy within Mercosur, which has "dwindled into a leftist talking shop", as an excuse for its absence, India has concluded very few agreements, from which much of the content has been eviscerated, as the negotiations went on (*The Economist*, 28 September 2013). The overall impression of a meandering trade policy in the Emerging economies has festered because of the eclectic use of trade barriers. Although some of these barriers, such as the

imposition of tariffs on imported lawn-mower blades in South Africa, almost seem comical, Gawande et al. (2011, 40) and Datt et al. (2011, 3) confirm that Brazil, China, India and Russia have all been among the most active users of trade policy over the past years.

But at the same time, despite strident warnings over the return of protectionism after the economic global downturn in the aftermath of the Subprime crisis, the fairly open trade regime – achieved with the comprehensive reforms in the mid-1990s – has proven robust. While some identified the advent of a "gated globe", with the aforementioned selective trade barriers imposed in the wake of the crisis, a relapse into all-encompassing protectionism has been staved off (*The Economist*, June 2012). Instead, Gawande et al. (2011, 40) and Datt et al. (2011, 3) show that after the crisis, the Emerging Market's governments have sanctioned almost as many liberalizing policies, as protectionist measures. Therefore, the applied average custom duties in the emerging economies, even in Brazil and India, as one of the most avid users of trade policies, barely budged. This stability has for instance been recognized by Drezner (2014, 85), who used this remarkable feat to show that the international institutional system and constraints worked. But both India and Brazil would have had substantial leeway in hiking the average applied custom duty, because they had refrained from lowering the average bound tariff rates in multilateral trade talks, which consequently hover well above the applied rates. Below the bound border, both countries are free to set their tariff rates, without risking to be punished through the dispute settlement process by other members of the WTO.

Thus while many feared that protectionist barriers would profligate, this fear has turned out to be exaggerated. But this feat had not been achieved because of idealistic national governments that would have felt bound by their solemn pledges during the various G20-summits and the innocuous agreements that committed no one to anything. This is especially true for the Emerging market's governments, which fought tooth and nail, to defend the interests of their domestic industries in the WTO trade talks. Instead, this project posits that this was achieved because the domestic industries staunchly opposed and thwarted the protectionist compulsions of other industries and that of the government. In cases when the government did impose import barriers for the short-term advantage of a specific industry, they were quickly jettisoned because other domestic industries cried foul. This led to the fact that the governments, besieged by uncompetitive industries did not descend into a protectionist tailspin, as can be seen in Figure 1.

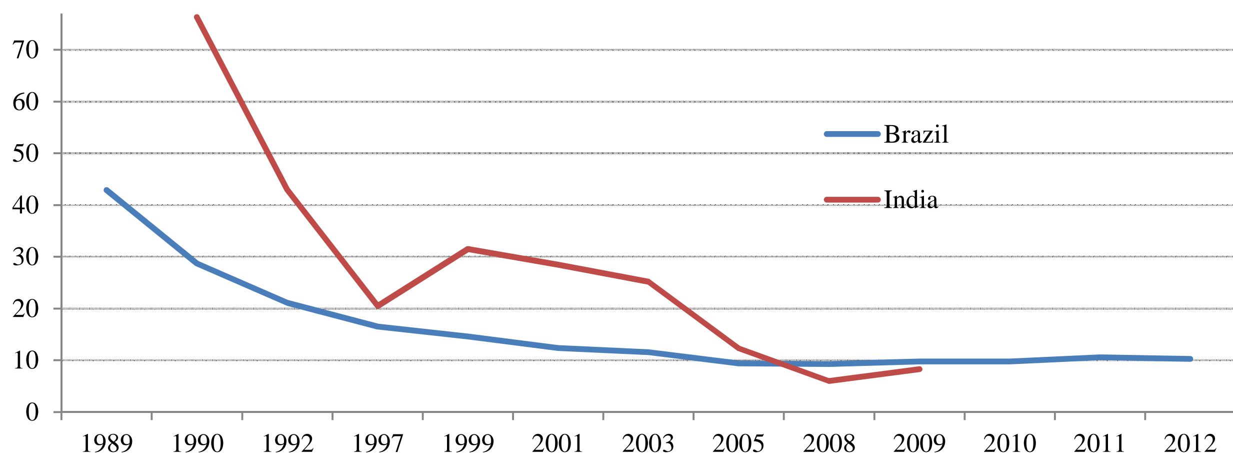

Figure 1: Applied average custom duties in Brazil and India; *Source*: World Bank (2015)

3. Case studies of the lobbying efforts by different industries

3.1 Operationalization and testing of the Interest Hypothesis

To empirically verify the above posited hypotheses, I will juxtapose the lobbying efforts of six different industries, which diverge in terms of their competitiveness and with regards to their dependence on foreign supplies of inputs, capital goods and the likes. To gauge the competitiveness and to rank the industries accordingly I have chosen to use the net exports as the main criterion. Additionally I have added the Brazilian and the Indian industries' shares in the world exports to convey an impression of their respective weight and clout in the world markets. The industries have then been chosen according to their comparative advantage, which according to the Heckscher-Ohlin model derives from the factor endowment in each country. Therefore I have chosen the Pharmaceutical industry, to represent the knowledge-intensive industries that benefits in a big way from the abundantly available university graduates in India. The knowledge-based Indian companies draw huge benefits from the fact that the Indian universities annually churn out 700.000 scientists, which can be employed at a fraction at what they would cost in the US or Europe, giving the companies a competitive edge over their overseas rivals. Brazil on the other hand profits from abundantly available land that can be harnessed for growing agricultural goods, such as soybeans. For the latter, the great *cerrado*-ecosystem, a sparsely populated area amounting to the same area provided of the twelve mid-western US-states reaching from Ohio to North Dakota (Goldsmith 2008, 773). As a result, the rental rates for soy growers in the center-west of Brazil are the lowest in the world (Goldsmith & Hirsch 2006, 97).

On the other hand, both Brazil and India have artificially curtailed the exploitation of the abundantly available cheap labors. Although India boasts the world's second largest population and Brazil has the fifth largest population, with income levels that are well below those in the industrialized nations, they have both struggled to draw in investments for the labor-intensive industries. While Brazil has made labor more expensive by a sprawling social security system (social security spending amounts to over

15% of Brazil's GDP, which is the same ratio as in the US), the Indian government has hampered the buildup of a staunch, high-volume manufacturing sector, due to restrictive labor laws that have effectively curtailed the number of employees for companies producing in India (Nölke et al. 2014, 14). As a consequence, India's apparel industry – which in the absence of restrictive labor laws thrived in the bordering countries – has had a somewhat wan trade performance over the past decade. The same goes for Brazil's car industry. Although the industry had been nurtured by the successive Brazilian governments and was a poster child for Brazil's strides in terms of industrialization, it is now increasingly losing its luster. Instead East Asian competitors from South Korea and China are gushing into the Brazilian domestic market, despite substantial import barriers. The problems of Brazil's car industry have been attributed to the high labor costs and the deteriorating technological capabilities of the Brazilian companies in this sector. The industries with the worst performance in terms of manufacturing in both countries are the producers of electrical appliances in India and those of machinery in Brazil. They have been both hard pressed and are flagging. Both of them are grappling with overwhelming competitive pressures, stemming from foreign competitors.

	Growth rate in the exports	UN Comtrade Net Exports*		from Competitiveness Map Share in world exports in 2013*
Brazil		1996	2013	
Oil seeds and oleaginous fruits		*0,7*	*22,7*	*23,25%*
Vehicles and parts thereof (cars)		*-1,1*	*-8,3*	*1,06%*
Boilers, machinery; etc.		*-5*	*-22,8*	*0,64%*
India				
Pharmaceutical products		*0,6*	*10,06*	*2,43%*
Articles of apparel		*2,7*	*8,5*	*4,30%*
Electrical, electronic equipment		*-0,7*	*-18,5*	*0,54%*

Figure 2: Industries in Brazil and India ranked according to their competitiveness (net exports); *Source*: UN Comtrade (2015) and International Trade Centre (2015)

3.2 The lobbying by the Indian apparel industry

To modernize, the textile sector whittles away trade impediments on textile machinery

The Indian textile industry is represented by the Confederation of Indian Textile Industry (CITI). The CITI represents the entire value-adding chain in the textile industry, including the spinners and even companies producing textile machinery. The apparel industry has formed a more specific industry

body and is represented by the Clothing Manufacturers Association of India (CMAI) and the Apparel Export Promotion Council (AEPC).

All of these business associations had pressed the government to lower the custom duties on textile machinery. According to their position papers, the required machineries were seldom produced in India, which is why they could only procure them from foreign suppliers. The preferences for sinking custom duties were sparked by the nearing abolition of the Multi Fiber Agreement in 2005, the beckoning vast markets in the industrialized countries and by the fact that India itself had lowered the barriers for textile imports, putting more competitive pressure onto the textile and apparel producers. In 2002 the Union Budget Speech by Finance Minister Yashwant Sinha echoed the views of the sector and proposed to lower the custom duties on textile machinery (he named automatic shuttleless looms and silk reeling, weaving and twisting machines) from 25% to 10%, to "enable the textile industry to modernize itself and acquire new technology" (Sinha 2002, 25).

Ten years later, in 2012, the apparel and textile industry successfully obtained the complete abolition of customs duties on textile machinery. The relevant business associations, such as the Clothing Manufacturers Association of India (CMAI), the Cotton Textiles Export Promotion Council (Texpprocil) and the CITI lauded this abolishment as a boost for the industry's efforts towards modernization as this would make shuttle-less looms cheaper (*Business Standard*, 17 March 2012).

With these demands the textile sector had prevailed over the exigencies of the domestic textile machinery sector. Just before the decision had been taken by the Finance Minister, the textile machinery's industry body, the Textile Machinery Manufacturers' Association (TMMA), had called for levying additional impediments on the import of textile machinery, by cementing the custom duties at the current level by deleting all the exemptions, which had reduced the efficient customs duty level to 5%. The association also called for an outright ban of imports of second-hand machinery (TMMA 2012).[2] When the Finance Minister, Pranab Mukherjee, therefore announced the abolishment of custom duties on the machinery, the machinery manufacturers called this a "definite" effort by the Indian government to "dis-incentivize the domestic manufacturers" (TMMA 2013). In his budget speech the Finance Minister had reasoned that the weaving sector, i.e. the apparel producers, "urgently needs to modernize", following the arguments by the Indian apparel industry (Mukherjee 2012, 32)

The seriousness of the Indian apparel industry to ward off any protectionist compulsions in the textile machinery sector was shown in 2008, when the National Manufacturing Competitiveness Council (NMCC), a government-constituted group, which was to craft recommendations to boost the Indian manufacturing sector, recommended to grant the subsidized credit lines under the TUF-scheme only if the textile company procured the machinery from domestic producers (NMCC 2008, 32). The industry bodies, such as the CITI, unabashedly opposed this notion out for fear that this might hamper their drive towards modernizing their production methods (*Mint*, 26 September 2008). After the Textile

[2] The Budget in 2012 also reduced the custom duties on second-hand machinery, which are seen as the main rivals of the Indian textile machinery industry, as the latter had focused on furnishing low-end machinery to the domestic market (*Indian Express*, 17 March 2012).

Ministry sided with the industry, the proposal came to naught. This short incidence shows that the textile industry refused to get enmeshed in a protectionist-patronage system of the Indian government like in the old days, where financial incentives were granted in exchange for the industry contending itself with minor-quality inputs and machinery, lest other, down-stream sectors go bust.

The Indian textile industry seeks to lower custom duties on synthetic fibers

According to the textile punditry, three-quarters of traded textiles are based on synthetic or "man-based" fibers, while cotton and other plant or animal-based fibers make up the rest (*Indian Express*, 18 June 2013). The Indian textile industry by contrast has strongly relied on its comparative advantage of easily available cotton. As a result it lags behind many of its international rivals, namely China, which mainly caters synthetic fiber-based textiles to the world markets.

This is perceived by the Indian business associations to be a major impediment on their export potential. So they push to allay the overdependence on cotton, to better serve the international markets. The CEO of Indian apparel producer called the share of synthetic textile in the Indian industry "abysmally low", which was due to the "high burden of taxes like custom duty and excise duty" (*Business Standard*, 19 May 2014).

As the industry increasingly perceived the chances stemming from the more porous borders to the rich western markets, it mounted the pressure on the Union government to ease access to imported synthetic fibers, to better meet the tastes of the overseas customers. As the man-made fibers are scantly produced by domestic Indian companies, the Indian business associations make the case for eliminating the custom duties on these inputs altogether. The industry has arguably made this one of the top priorities in its pre-budget proposals lodged with the Finance Ministry before the budget is crafted. In his budget speech in 2005, the Finance Minister recognized the "new vigour" (Chidambaram 2005) in the sector and reduced the custom duties on man-made fibres and other intermediary goods for the sector from 20% to 15%. In line with the demands of the textile sector the following budgets in 2006 and 2007 furthered the gradual reduction in tariff rates from 15% to 5%.

The demands by the industry were given more weight since it could tout the employment potential of the sector. It said that if the industry was given the opportunity to increase its competitiveness in the world markets, by allowing it to "augment exports of garment made of synthetic clothes", it would be able to "easily absorb a substantial portion of unemployed people" (*The Hindu*, 22 December 2006). With this argument, pitched in meetings with the Finance Minister, the Commerce Minister and the Prime Minister, prior to the budget formulation, the industry's bodies achieved substantial cuts in the tariff lines of the downstream industries.

In 2007 the Indian textile industry harnessed the detrimental effects of a rupee appreciation for their lobbying efforts. Although exports actually kept rising over this time interval, the industry's body, CITI, cautioned the government that the appreciation of the rupee would eventually lead to job losses,

by curbing the export opportunities, and clamored the government for a relief package (*Indian Textile Journal*, 15 October 2008). The relief package followed suit and included the reduction of custom duties on several synthetic man-made fibers, such as polyester filament yarn, from 7.5% to 5%. The reductions in the customs duties on these key intermediaries have been lauded by the business associations as the most significant component of the relief package by the government.

While the Indian apparel industry kept pushing to completely remove customs duty on man-made fibers, it was countered by the AMFII, the Association of Man Made Fiber Industry of India. The latter made clear that it preferred the status quo over the removal of custom duties, but assured the Finance Minister that in case the custom duties should be lowered, it would need the import duties on its inputs to sink as well. Surprisingly in its proposal the AMFII was sided by the CITI, which had in the past insisted on lowering the tariffs on synthetic fibers (AMFII 2012).

Faced with the opposition by the Indian textile industry towards hiking the regular custom duties and due to the successive lowering of the import barriers, the domestic producers of these downstream products took matters into their own hands. The companies started to ask the government to file anti-dumping complaints with the WTO and to levy anti-dumping duties on inputs used by the textile industry.

The producers of the synthetic fibers are part of the petrochemical industry. This industry segment has been especially prone towards launching dumping complaints with the Indian government. According to Feinberg (2010) and Bown & Tovar (2011), the chemical industry accounts for over 80% of India's anti-dumping cases. The domestic production of man-made fibers in India is dominated by a few big players (Ministry of Textiles 2010, 39). The most notable company is Reliance Industries. This Indian conglomerate, which is active in retail, telecommunications and construction, also has a petrochemical segment, which dominates the sector and has considerable pricing power. Due to the concentration and monopolistic rents they have the resources and capabilities to write petitions to the Ministry of Industry and Commerce and elaborately present their case.

This has led to complaints by the Indian textile sector which feels that the small-scale, decentralized spinning and weaving companies cannot match the lobbying efforts by the "global scale units" in the Indian petrochemical industries (*Yarns and Fibres*, 29 April 2007). As the anti-dumping investigations spread like wildfire in the intermediary sector for the industry, the CITI called for the abolishment of all the anti-dumping duties on man-made fibers and called for a halt of all fresh anti-dumping considerations in these product segments in its pre-budget memoranda (CITI 2010; 2007).

While the anti-dumping duties were always restricted to very specific products, such as viscose filament yarn in 2006 or nylon filament yarn in 2005, by 2012 almost all segments of synthetic yarn were covered by anti-dumping duties (*Times of India*, 7 December 2012). So despite the strong opposition by the textile industry, the petrochemical industry managed to raise the protection of many

of its products. After rendering the imports more expensive through additional tariffs, the domestic producers of man-made yarn reportedly increased prices by 30% (Ibid.).

The government's faltering stance vis-à-vis Indian cotton exports creates incendiary conflicts

The Indian cotton industry is the second largest producer of cotton, which is the staple for the Indian textile industry. The availability of cotton in India is considered a major strength of the industry. The value of imported cotton is paltry in comparison to the exported volume. The latter outstrips the former by eight times. The main destinations of India's cotton exports are the Chinese spinning mills. The Indian apparel industry also benefits from a modernized spinning industry, which turns the raw cotton into spun yarn, which in turn is processed by weavers into clothing and apparel. The exports of spun yarn are mainly headed towards the Chinese weavers, but Bangladesh sources an increasing share as well. Together they both buy 50% of the exported Indian spun yarn (*Yarns & Fibres* 2013).

In autumn 2010, the domestic clothing industry thrust cotton and yarn onto the political agenda. The worldwide surge in demand for cotton had led the prices for it to all-time highs, leaving the cash-strapped Indian textile industry scrambling for their inputs. In its letters towards the Indian government and in its public statements the sewing industry vented its anger that the benefits of the homegrown cotton were rather available to the foreign competitors, than to the Indian industry (*Financial Express*, 14 September 2010). The government's reluctance to intervene unnerved the industry's representatives, which accused the government in a letter addressed to the commerce and industry minister, Anand Sharma, to be too strongly concerned over the neighboring countries' welfare, rather than to nurse India's ailing industries. The meetings, memos and letters dashed off towards the government were given more weight with a daylong strike of the sewing units in India in November, initiated by the Apparel Export Promotion Council (AEPC) (*Financial Express*, 8 November 2010; *Economic Times*, 19 November 2010; *Business Standard*, 16 November 2010). The industry feared that the internationalization of the cotton sector would sap the mainstay of the industry's competitive advantage. To justify the shutdown in the operations of India's apparel industry, AEPC's president denoted that cotton yarn was either exported to Bangladesh or China. Therefore he concluded that the opening of the Indian yarn and spinning sector directly bolstered India's competitors (*Business Standard*, 16 November 2010).

In January 2011, the government finally yielded to the industries' exigencies and imposed a ban on exports of cotton yarn. The international repercussions were deliberately ignored by the business associations, which was dismissive over the effects to the other countries as the AEPC's chairman was cited with the remark that every country ought to look after its own industry (*Dawn*, 5 December 2010). It was also deaf tone to the objections of India's spinning industry, which benefits from the high international prices and reportedly produces more cotton yarn than the Indian sewing industry needs. That is why, the industry was riven over this policy and AEPC threatened to leave the industry's umbrella association, the Confederation of Indian Textile Industry (CITI), which represents

both the Indian spinners and the sewers. CITI had, after some hesitation, decided to speak out against the export ban as it hurt some of its members.
The forced temporary exit of India's comparatively competitive spinning sector, which produces yarn, has been derided by observers of the industry. After the government relinquished the ban, because of the spinners' persistent protests, the spinning companies had to revive their contacts with overseas buyers and were saddled with unsold stockpiles. The government on the other hand again faced nationwide strikes. This time the spinning mills pressured them for compensation through export incentives, as the prices for yarn in India had fallen by 50%, which naturally flustered the companies that had produced the yarn and left them gasping for government aid (*Financial Express*, 24 August 2011; *Economic Times*, 10 Ocotber 2011).

The temporary ban yielded no winner and had predictably done little to alleviate the volatilities and the trend towards higher cotton prices. Hence the groans of the textile industry continued. The industry's bodies again rallied against Indian exports to China. This time they chastised Indian cotton exports and claimed that the Indian cotton exports would menace one of the few competitive advantages of the Indian apparel industry. It accused the Chinese government of stockpiling Indian cotton to increase their cotton reserves, depriving the domestic industry of its major input (*Mint*, 7 March 2012; *fibre2fashion*, 24 February 2012). With its talk over the detrimental effects of raw cotton exports on the upstream industries, it had apparently struck a chord with the commerce and textile ministers. The representatives of both ministries argued that they were curbing the sinister threat of an unfolding Dutch disease, by banning exports of cotton (*Financial Express*, 6 March 2012). The Dutch Disease refers to the loss of the competitive position of a country's manufacturing sector because of a currency appreciation, triggered by vast exports of raw materials. This scenario appears unlikely in India, as the economy displays a vast and persistent trade deficit. When the union cabinet moved to completely ban cotton exports in March 2012, the gambit came as surprise to some quarters of the proper government. The minister for agriculture was cited of not having been informed over the forced temporary exit of Indian cotton from the world markets. It immediately called the prime minister to revoke the ban, as the association of cotton industry lamented that the domestic textile industry was calling for a halt in imports, whilst refusing to buy any significant amount of cotton itself (*Financial Express*, 14 April 2012).

Hastened by the sewers, the government, - overnight - disallowed cotton exports that had already been registered with the Indian administration but had not yet been shipped. This precipitated an abruptly sagging demand for Indian cotton. In a predictable pattern, the groups afflicted by the protectionist gambit shouted for support. In some districts the aggrieved farmers turned violent and resorted to setting trucks ablaze (*Economic Times*, 7 March 2012). Equally predictable, the union government hurried to placate the cotton growers. This time it sought to soften the farmer's ire by ordering the government-owned Cotton Corporation of India to purchase cotton at a reasonable price from them,

putting further strain on the public budgets that are already suffering from the galloping costs of India's sprawling subsidy system (*Financial Express*, 11 April 2012). In the end of April, a few weeks after the government had blundered into this intervention, it relented and agreed to finally re-open the export registration for the produce of the cotton growers. The evaluations of the policy impact were trenchant and the pursued policies do not suggest that the government charted a coherent policy. After the successive export bans on cotton and yarn and the subsequent repeals, observers felt that ministers were now arbitrarily imposing export bans, which sent an unsettling signal to the world markets, significantly eroding the confidence in the reliability of Indian exporters. Furthermore, the temporary actions did little in allaying the volatilities in the cotton market, as shortly after the halt had been revoked, the textile industry reiterated its concerns that cotton was funneled to the Chinese market. The Textile Ministry's attempt to levy a 10% export duty of cotton exports was quelled by the obstreperous cotton associations and textile traders, which convinced a group of ministers to rally for the extant free-trade-regime for cotton (*Financial Express*, 12 September 2013; *The Hindu*, 25 October 2013).

Conclusion regarding India's apparel industry

The progress in the liberalization of the Indian textile sector seems to reflect the overall progress in all of India. There are some steps towards freer markets, which are then countered by steps going into the opposite direction. While the apparel companies spawned free trade in textile machinery and helped in lowering the customs duty on cotton and synthetic fibers, it had no qualms to spur protectionist reflexes, when it forced Indian cotton out of the world markets. These protectionist compulsions were a result of the competitive disadvantage vis-à-vis the Chinese apparel producers, which imported the lion's share of Indian cotton.

The case study also demonstrates the government's highly reactive policies that impose tariffs or liberalize trade not within a comprehensive strategy to deal with the long-term challenges of the industry but rather to placate the short-term demands of the different industries' associations. Instead the policies have been improvised, tactical and therefore internally contradictory.

The eclectic protectionist gambits by the Indian government had led to immediate pile ups of not-exported cotton and cotton yarn stocks, whose availability eroded their price level, as the Indian market was now awash with this feedstock of the apparel industry. The ban was especially frustrating to the cotton growers and spinning mills, because the domestic apparel industry did not fill the demand gap. The sewers were cash-strapped and increasingly engulfed in a financial crisis. During the demand boom in the mid-2000s they had overleveraged in order to increase their production capabilities. This debt-fueled investment spree had been enticed by the government sponsored TUF-scheme. The sewers thus simply could not afford to increases purchases of cotton.

Therefore the intervention did little to pre-empt or cushion the financial crisis in the textile industry. The credit crunch was only resolved in 2013 after the state-backed banks, which beforehand had been

pressed to supply credits to the industry, restructured the loans. Thus instead of resolving the underlying structural problems of the textile industry, the Indian government –at the behest of the flailing sewers - had first punished the relatively competitive downstream industries through ad hoc measures, which frustrated the latter, but yielded only a passing boon for the apparel industry. All in all, the intervention struck the cotton growers that subsist by toiling on relatively small farms and hurt the spinning mills that had extended a lot of capital to modernize their production facilities, without resolving the sewers' underlying problems.

3.3 The lobbying of Brazil's car part industry

The tussle with the Brazilian steel industry

After the industry had weathered the transformation process triggered by the liberalization of the economy, the auto parts sector turned quite sanguine about their export potential. Despite the many price adjustment of the suppliers of the raw materials, the auto parts companies saw their exports increase. The regaining of the competitiveness was derived from the widely available raw materials in Brazil, the relatively cheap labor and a functioning metallurgy, as the Brazilian government had built up several fully integrated steel mills (*Auto Press* 2000). Hence Brazil had become self-sufficient in steel products from the 1960s onwards (Bergsman 1970, 113). Despite many organizational deficiencies, resulting from building the steel mills from scratch without prior experience, which had curbed the efficiency of the steel mills, the industry could rely on one of the world's largest high-quality iron ore reserves and the cheap supply of other necessary raw materials, such as limestone, manganese and hydro-electric potential (Ibid, 117). This is all the more important as steel is one of the most important inputs for the auto parts industry. Despite the natural competitive advantage that the steel industry enjoys, the auto parts industry has ever since the liberalization of the economy complained about the frequent tinkering of the steel industry with the prices. According to the industry's business association, the share of raw materials in the cost structure has subsequently risen from below 40% in 1995 to over 60% in 2008. These figures were used by the industry, to deplore the price setting by their suppliers, whenever the latter announced price increases or when they themselves tried to pass on the cost increases towards their customers, the vehicle assemblers (*Valor Econômico*, 5 May 2005; *Exame*, 15 May 2008). Within this cost share of the raw materials, steel is the most important factor. A representative of Sindipecas claimed that flat steel contributed 15% of the price of the final car, while alloy steel determined another 9% of the car's price (*Valor Econômico*, 15 May 2001).

The attempts to dislodge/ circumvent the Brazilian steel cartel

With the advent of the liberalization of the economy in the mid-1990s, the industry started to feel sandwiched between the demands for price cuts from the auto assemblers and the price increases by the providers of the raw materials. A probe into in the business practices and the price setting of the producers of flat steel, i.e. the single biggest contributor to the cost structure of a car, conducted by CADE, the country's antitrust body, shows the flagrant price-fixing that is taking place in the Brazilian steel industry. The three biggest producers, Cosipa, Usiminas and CSN, had been alleged of having agreed on a hefty price hike in a meeting at industry's association, the IBS on 30 July 1996 (World Bank, 2004, 25). Although CADE and Ministry of Finance's Secretariat of Economic Monitoring (SDE) issued a warning against this behavior, the three companies went ahead and – with marginal deviations in the price rates (between 3.59% and 4.09%) – they each announced their price raise. This kind of parallel behavior can in Brazil form the "base for suspicion for illegality" (CUTS International 2007, 14). As the country's antitrust watchdog, CADE, could not discern a "rational economic explanation" for the rising prices, it found the three steel companies guilty and imposed a fine of R$ 50 million (CADE 2009, 26). This had been CADE's first punition of a cartel in Brazil. This was welcomed by the car industry, which deplored the negotiations with the suppliers of the raw materials and called them "oligopolies".

Nevertheless, the government body has remained relatively ineffective. This has compelled the *Financial Times* (23 December 2013) to deride CADE as a "bureaucratic nuisance with little real power". Its decisions were often overturned by judges or they were only allowed to investigate, after important decisions, such as mergers and acquisitions had already been completed. Furthermore, the steel industry in Brazil is still prone towards oligopolistic overpricing because of the relatively low punitive costs, imposed by CADE and the lack of compensation measures for the aggrieved victims of the illegal price setting (Carrasco & Pinho de Mello 2010). The forging of cartels in the case of steel is further facilitated by the fact that rising prices will not necessarily attract investments, because of the high sunk costs that can be expected. The German conglomerate ThyssenKrupp for instance was edged to the cusp of bankruptcy between 2013 and 2014, after the company had sunk over $15 billion into a steel plant in Brazil and a processing unit in Alabama. But as the project has been plagued by galloping costs and pockmarked with operational problems in Brazil, and was furthermore saddled with overwhelming overcapacities, ThyssenKrupp is desperately seeking to shed the Brazilian loss-making subsidiary (e.g. *Wall Street Journal*, 4 March 2014). With these difficulties that can be expected upon market entry, the domestic steel mills only face the threat of imported steel that could undercut their price-making capabilities in Brazil.

As a consequence, the steel industry and its customers, namely the car industry and the car parts industry have sparred fiercely over the trade regime in the steel sector. Ever since 1999, when the sole successful investigation by CADE had been imposed, further investigations have been shelved or ran

into an impasse. Thus Sindipecas and Anfavea turned to the relaxation of imports, to obtain a levy against the pricing policies of the steel producers.

But before they could solicit the abolishment of custom duties, they first had to fend off the protectionist compulsions of the domestic steel industry. In February 2002 the industry bodies of the vehicle assemblers and that of the producers of auto parts became very agitated after the steel industry had managed to thrust a potential increase of the import duties on all steel products onto the government's agenda. For this it had used a major glitch in the US administration's commitment to free trade under George W. Bush. To placate the voters in the so called Rust Belt (cover economically deprived states such as West Virginia and Pennsylvania), the US-president had imposed custom duties on a selected number of steel types. This gambit by the US-administration spawned heavy criticism from around the globe. Even the EU-Commission announced its willingness to usher in retaliatory measures. While the US move also drew heavy fire from the Brazilian steel industry, the Brazilians government surprisingly refrained from indulging in a tit-for-tat spiral.
After the US government had extended their anti-dumping duties on steel originating from Brazil, and other countries, the Brazilian Steel Institute had lobbied for a linear increase of import duties on steel products, intending to enter the Brazilian market. The industry's associations and the unions staged protests and issued strident warnings over the detrimental impact on the industry. While the unions warned that the US tariffs would endanger 5000 jobs, the industry bodies posited that the Brazilian steel mills would lose out on $1 billion in revenues (*New York Times*, 14 March 2001).[3] The Development Minister, Sergio Amaral, echoed their view and publicly mused about the necessity of such a measure. However, he dampened the expectations because increasing the custom duty would first require consultations with the other Mercosur partners as such a measure would necessitate the increase of the Common External Tariff (CET), to which all Mercosur members need to give nod (*Folha de S Paulo*, 26 February 2002; 27 March 2002). This sparked heavy lobbying from the Brazilian automotive industry, which are one of the steel mills main customers as they buy up one quarter of the products produced by them. The producers of autoparts sent forward the battle-hardened president of Sindipecas, Paulo Butori, who made clear that such a step would necessitate increases in the custom duties on the up-stream industries as well. He cautioned the government that custom duties on steel products, amounting to 12% already exceeded those for car parts, which stood at slightly above 10%. The president of Anfavea seconded the lobbying efforts of Sindipecas and pointed out that higher protection for the steel sector would probably lead to higher steel prices in Brazil, exacerbating the problems of the auto industry, stemming from the idle production capacities (*Estado de S. Paulo*, 15 April 2002). Just a day later, after another lengthy meeting with the Development minister Sergio Amaral that lasted for two hours, Sindipecas' president contended that the Brazilian government

[3] The *New York Times* (14 March 2002) reported that the protests by the unions took on "more of the air of a block party", where protestors "barbecued hamburgers and danced cladded in swimsuits and Uncle Sam hats between protest chants".

would refrain from heightening the custom duties on steel products coming into Brazil (*Valor Econômico*, 16 April 2002).

But the car industry did not stop at warding off the threat of higher custom duties. It continued to deplore that steel makers could leverage their possibility of exporting steel to foist price increases on them. Thus while the steel makers could plausibly threaten to take their products elsewhere, the car industry had little leeway in sourcing products from abroad and were thus severely restrained in the price negotiations (*Exame*, 22 November 2002).

Therefore the simmering conflict lingered on, until 2005 when an egregious price hike by the Brazil's steel mammoths reignited the sparring between the two industries.

While Sindipecas alternated between the rejoicing over the buoyant demand and complaints over the limited production capabilities, as the "factories are working four shifts, 24 hours a day, seven days a week", according to Paulo Butori (*Folha de S.Paulo*, 27 October 2004), Anfavea, the industry body representing the vehicle assemblers started to table studies on the government's agenda, showing that the price for steel had increased by 149% from January 2002 to December 2004, and denoting a surge in the prices for plastic (+95%) and one for non-ferrous metals (+79%) (*Folha de S. Paulo*, 5 May 2005). But even for Sindipecas, the steel industry increasingly muscled itself onto the political agenda, as steel prices continued to rise and the industry body struggled to elicit price increases from their costumers to compensate them for the increases in their costs (*Exame,* 23 June 2004). These efforts towards its customers, i.e. the car assemblers, were paralleled by cost reducing measures. The respected daily newspaper *Valor Econômico* (25 August 2004) even spoke of a fierce war that waged between the auto industry and the steel mills in this period. Politically, Sindipecas wanted to obtain resources from the government to expand their production capabilities as the capacity utilization vacillated at around 90%. The second most important complaint, however, was the surge in the Brazilian steel prices. Thus it did not come as a surprise to Sindipecas and Anfavea, when the government razed custom duties on fifteen types of steel in March 2005, after the mining company Vale (known as Companhia Vale do Rio Doce prior to 2007) had raised the prices on iron ore by over 70% (*Diário do Grande ABC,* 4 March 2005). The Brazilian government used the opportunity of being able to put some goods onto the Mercosur's CET exemption list and thus freed steel imports from any custom duties. The decision was surrounded by muted enthusiasm on the part of the car industry. It welcomed the decision but its representatives reckoned that the decision would only start to take effect in the longer term. While Sindipecas did not utter any reactions at all, the auto assemblers remained reserved. The option of importing steel from abroad as a substitute for Brazilian steel was not a beckoning alternative for the car industry at that time, because the price surge had taken place on a global scale. Moreover, the car manufacturer's lobby group contended that the freight, shipping and insurance costs would add additional costs of 15% to the bill on steel, sourced

from abroad (*Folha de S. Paulo*, 29 March 2005).[4] But Anfavea opined that the measure could become an option for sourcing cheaper imports in the future and that this possibility could be levied as a negotiating tool with the steel industry in the upcoming contract negotiations (*Folha de S. Paulo*, 5 March 2005).

Almost immediately after the razing of the import tariffs, the global steel prices floundered, as Chinese steel exports went up and high global inventories dampened the demand for steel. The car manufacturers Volkswagen and Ford were the first to import batches of steel from abroad, after the negotiations over price rebates on Brazilian steel had come to naught (*Valor Econômico*, 18 August 2005). Thus the imports of iron and steel increased from relatively modest $0.53 billion in 2004 before the liberalization to $3.32 billion in 2008 (Comtrade 2014). With the increasing cleavage between sagging prices for steel on the international market and the staid prices in Brazil, the auto parts industry revved up the pressure on the steel mills. In June 2005 Sindipecas' president personally lambasted the pricing policy of the Brazilian steel makers that clutched to the old price level all the while prices had gone down by 20% in the international markets (*Valor Econômico*, 10 June 2005). Thus the industry used the zeroing of the custom duties to increase the pressure on the domestic steel mills and managed to eke out some discounts from the Brazilian steel producers who were forced to cave in, after the price differentials between the different steel products had become too glaring. In 2009 for instance the international priced for hot coil stood at between $400 and $450, while the Brazilian metallurgy solicited $700 for the same product (*Estado de S. Paulo*, 6 June 2009). With these high costs for raw materials, the Brazilian auto parts industry incurs another competitive disadvantage vis-à-vis the Western producers in high-cost Europe. According to the consultancy Roland Berger, Brazil offer cost disadvantages due to higher prices for raw materials, higher distribution costs, due to a crumbling infrastructure, costs stemming from a suffocating bureaucracy and impenetrable tax laws (the infamous "Custo Brasil"), and lastly because of lower scale effects (Roland Berger 2010, 9).

Over the next year, the industry bodies commissioned several studies with the universal refrain of input costs being too high. The perfunctory lobbying in this time served to ward off the steel makers' demands for the re-introduction of custom duties on steel. The studies conducted by Sindipecas with the support of the consultancy Booz Allen Hamilton (e.g. in May 2007 and April 2008) also served to identify bottlenecks in their supply chain.

But after a strong campaign, orchestrated by the Brazilian steel institute, the steel industry again managed to wrest protectionist concessions from the Brazilian government. By rallying the labor unions to their banner –including the largest and most important labor federation, the Unified Center

[4] According to the president of Sindipecas, this fact has been used by the steel mills to slap a 15% convenience charge ("*taxa de conforto*") on the prices for steel (*Exame,* 2 December 2005).

of Workers (Central Única dos Trabalhadores - CUT) - the steel producers managed to hive the steel products off the duty-free products list, that are exempted from the common custom duties stipulated by the CET (Ibid). Just three months thereafter, Sindipecas again complained over the price rises of the steel producers that had insisted on a price rise of 13% on their products, which bore very close resemblance to the reintroduced custom duty of 12% to 14% - (*O Globo,* 10 September 2009). Just after the custom duties had been reinstated, the Brazilian steelmakers, CSN and Usiminas, sought to renege on the discounts granted to their customers at the beginning of the year and announced price increases in the range of 10% to 13%. This emanated distress calls by the car industry, which warned that the price hikes on steel might thwart the incipient sign of their recovery. This in turn engendered warnings by Brazil's finance minister, Guido Mantega. He threatened to withdraw the reintroduction of the custom duties, if the steelmakers were to continue their price increases (*Folha de S. Paulo,* 22 September 2009). He warned that he would keep a close eye on the development of the prices and opined that the high idle capacities would not justify the price increases of the steel producers. His remarks were evidently seconded by the automotive industry.

Trying to spark unilateral protectionist measures

The Brazilian producers of car components loathed the freeing of trade, implemented through the substantial tariff cuts by Cardoso's administration in 1993. In order to break the hyperinflationary spiral that had fed from ever-increasing prices on goods and salaries, the administration had sought to enhance the stabilization of the prices, by fueling competition through lowering import barriers. Trade policy was therefore subordinated to the overarching goal of achieving price stability and achieving credibility in the international financial markets, after the previous administrations had squandered their respective goodwill with populist and unsustainable improvisations (Gómez-Mera 2007, 121). This time the memories of the hyperinflation that hat attained annual rates of up to 2500% had stuck in the politicians' memories and most of the government members remained firmly committed to the price stabilization goal. Thus unlike the auto parts sector, the assemblers of cars - as arguably the most potent lobbying industry - were the only sector that had been exempted from the thorough razing of import tariffs (Schneider 2004, 219). Complaints and calls for protection by the foundering auto parts industry by contrast were not abetted by the government, which pointed out that the macroeconomic stabilization was not yet cemented and feared an unraveling of their stabilization efforts, if they were to cave in to protectionist compulsions (*Exame*, 3 July 1996).

With this steadfast commitment, the government had pre-empted lobbying efforts by the industry that realized that they would be to no avail. Instead the industry body focused on accompanying the strenuous restructuring efforts undertaken by their members. While the industry started to adapt itself to the new circumstances, the industry was increasingly riven. Reflecting the bifurcation of the industry into tier-1 suppliers that cater directly to the car assemblers and the other suppliers with no direct contact to the car manufacturers, Sindipecas was threatened by an internal split. The industry

body's president avoided this looming threat, by creating two forums for the two respective economic currents under the roof of Sindipecas. The president on the other hand was mandated to mediate between the two sides and to broker compromises (*Valor Econômico*, 15 April 2011).

After these turbulent years in the direct aftermath of the reforms, the industry managed to stabilize. Therein it was assisted by the local content rule, which – albeit diluted and lowered – assuaged the restructuring pains by forcing car assemblers in Brazil to source 65% of their components from Brazil-based factories. This allowed them to coast in the tailwinds of the debt-fueled buoyant demand from the 2000s onwards. In February 2001, the auto parts industry barely demurred at the introduction of a provisional measure that introduced a 40% deduction on the custom duties paid for imported auto components, by the assemblers of cars.[5] Unnoticed by the industry, this provisional measure even turned into law as the Congress had decided to turn provisional measures into law, if the measures were not rejected within a certain time frame (*Valor Econômico*, 3 February 2006). Thus they became set in stone almost by accident and were barely noticed by the industry.

The benign neglect of the barriers for imports changed with the rise of the Asian competitors. In 2000 the share of the value of imports from China and South Korea meandered at only 0.5% and 0.6% respectively. Instead imports from the US and Germany, each with a share of almost 20%, topped the list. But this share lurched downwards to a little over 10% in 2013. Chinese and South Korean imports by contrast surged in absolute and relative terms and catapulted both countries to the 4th and 5th place respectively. With a share of 8.4% to 8.6%, respectively, they are sharply trailing the old heavyweights, Japan, Germany and the US. In the early 2000s, the Brazilian industry was still optimistic that the rise of China would lead to higher demand for Brazilian auto parts. During the 2002 presidential campaign they penned letters to the contending presidential candidates asking them to stimulate the demand for cars and auto parts. To shore up the demand for Brazilian products they clamored the candidates to negotiate free trade agreements with China and India because they allegedly both featured similar consumption patterns as Brazil, making it likely that the Brazilian companies were well placed to cater to their demand (*Valor Econômico*, 24 July 2002). This assessment of China as a huge market for Brazilian products started to turn sour just a few years later, when the exports to China started to sputter and instead the imports began to be ratcheted up by companies based in China. Although Brazil still eked out a small trade surplus in 2005, the worries over China as a competitor were fueled by the dynamism, by which China started to substitute imports through strong investments by foreign multinationals and domestic players. The changing tides were likened to the rapid ascent of South Korea and Japan only that China had an even vaster population, thus being more ready to emulate and outstrip the low-cost strategy steered by Brazilian companies. The threat of China was much stronger accentuated in Brazil, because they encroached on those - rather low-tech - product segments, where Brazilian producers had carved out a niche for themselves.

[5] This policy was tailored to the demands of the car assemblers, as retailer, who would not process the cars parts, but rather resell them continued to pay the full custom duties, without the rebate of 40%.

Thus they started to sound the alarm, when Chinese flashlights and tires were offered at much lower prices in Brazil than those manufactured in Brazil, despite the custom duties and the freight costs (*Valor Econômico*, 7 December 2005). In 2005 the industry clamored the government to abolish the reduction worth 40% on the custom duties paid on the imports of car parts.

In 2006 the Chinese manufacturers – despite having achieved only a scant trade surplus – started to flex their muscles in Latin America. The *Valor Econômico* (31 March 2006) quoted an executive of Lifan Industry, who visited Brazil, as having said that his company wanted to continue to learn building engines and vehicles whose technology they had still not mastered, to avoid imports into China. The worries were also not eased by the low quality of the first Chinese cars, showcased at auto fares in the region, such as in Caracas, Venezuela. Instead Sindipecas' president pointed out that the first Japanese and South Korean cars had also been derided by the competitors but then, within a few years, they had become the fiercest contesters (*Valor Econômico*, 7 August 2006).

The surge in imports from China further jangled the nerves of the industry's companies and representatives. The unease of the industry was palpable when the Asian competitors had started to snap a substantial and growing share of the market over the next years. This development was steepened after the global financial crisis had plunged the demand for cars on a global scale. The Brazilian demand by contrast had proven relatively staunch, thus attracting the interest of many companies from abroad that sought to utilize their idle production capacities after the growth slump, to reduce their costs and rev up their revenues. After 2009, the industry for the first time since 2002 posted a substantial trade deficit. As Sindipecas' president, Paulo Butori signaled that this trend would likely accentuate over the coming year, the industry came through to the government in April 2010. No one less than President Lula da Silva was said to be personally concerned over the widening trade deficit in the auto-parts industry and the electronics sector. The development minister, Miguel Jorge, also rushed to assure the public that the administration was "sensitive" to the industry's demands (*O Estado de S.Paulo*, 14 April 2010). From there on the government seriously pondered the idea of razing the rebate of 40% on the custom duties paid for imported car parts, which had lowered the tariffs to effectively 8% to 10% (*Exame*, 14 April 2010). Although the car assemblers tried to intervene and cautioned the government and especially the Finance Ministry over the detrimental effects on their cost structure, the industry was able to maintain the momentum for increased protection, as the trade unions, such as the Unified Workers Central (CUT) and allied industry bodies, such as Abifa, representing the Brazilian foundry industry and Abimaq, the industry body for machinery and equipment, threw their weight behind the demands and met with the Minster for Development (*Valor Econômico*, 28 April 2010; *O Estado de S.Paulo*, 28 April 2010).

Although the Finance Minister still had some objections, the government decided in May 2010, to stop the reduction in the tariff rates and to revert to the levels, applied prior to 2001 (*O Estado de S.Paulo*, 7 May 2010). The protests by the auto assemblers had been tempered by Sindipecas, which offered that it would collate a list of those products that were not produced in Brazil and could therefore be

imported at a significantly reduced import duty. With this tactic, it countered Anfavea's argument that the rise in the effective custom duty rates would lead to rising prices for cars and therefore stoke inflation. This gambit blunted the confrontation between the upstream and the downstream industry and allowed Sindipecas to insist on this protectionist tweak in the legislation, by stamping out the former provisional measure granted to the car assemblers in the early 2000s.[6]

As the complaints by the car assemblers over the quality and the prices of Brazilian-made auto parts showed, it was unlikely that the steady stream of imports into Brazil would be clogged up by this moderate increase in the custom duties. The industry soon remarked that the import stream had barely been dented by the re-established former custom duty levels. Thus when the car assemblers, represented by Anfavea, lobbied for increased protection by clamoring the government to raise the industrial-product tax for imported cars, Sindipecas ceased the opportunity to lobby for a ramped up local content rule. While the official local content rule stipulates that the assemblers need to source at least 65% of their components in Brazil, Sindipecas argued that this rule had been diluted by a flawed formula that allowed the car assemblers, to declare costs, stemming from activities unrelated to the production process, as locally sourced services or products, which included expenses for marketing activities and political lobbying. Moreover it lamented that insufficient controls has led to the fact that parts in cars imported from Argentina were mostly sourced from China, but that the Brazilian customs could not ascertain their origins, because of a flawed and insufficient surveillance mechanism. Thus, as soon as Anfavea lodged studies over the necessity of protectionist measures for its members with the government, Sindipecas was quick to remind the government over the need for local content rules, which would have more teeth (*O Estado de S.Paulo*, 4 June 2011). To come through with this demand, the industry sidestepped other issues, such as the cascading effects of the panoply of taxes on their activities, the high social security contributions and even the high capital costs (*O Estado de S. Paulo*, 13 June 2011).

Because the Brazilian makers of auto parts were right in expecting higher demand from domestically manufactured cars, rather than from imported ones, they supported Anfavea's demands for raising the sales tax, called industrial-product tax (IPI) for imported cars, to render the latter less competitive. But it never failed to try to thrust the need for a bolstered national content-rider onto the political agenda. Thus it cheered the eventual raise in the IPI-rates by 30 percentage points to 37%-55%, promulgated by the government in September 2011. The only way to avoid this raise was for car assemblers to spend 65% of their expenditures in Brazil, making it practically impossible for importers to be exempted from the tax increase. These new rules were to become effective starting the next day (*Exame*, 19 September 2011; *The Economist*, 24 September 2011). By hastening the process, the Brazilian government was likely to make themselves susceptible towards allegations by foreign importers who - according to the WTO stipulations - should be granted a 90 days' notice before

[6] Anfavea only managed to extend the stipulated phasing out period of the legislation from initially six months to nine months, because some orders were still being processed (*Valor Econômico*, 17 June 2010).

changing the law (*The Economist*, 24 September 2011; *Valor Econômico*, 13 December 2011). By rushing to implement the rules the government, aiming at putting an instant stop on the rising imports, also put the investment plans by different foreign companies in peril. While the companies already present in Brazil lauded the government's gambit, the requests of the Chinese Chery Automobile and JAC Motors, as well those from BMW and the Japanese Suzuki to build up factories were snubbed by the Finance Ministry and even to a lesser degree by the Development Ministry. Anfavea threw its weight behind the Finance Ministry's position by claiming that the government needed the revenues and should refuse to budge in order to achieve a balanced fiscal budget (*Valor Econômico*, 13 December 2011). This might have been the first time that a Brazilian industry body lobbied the government to prioritize fiscal consolidation over the economic development, strongly indicating that Anfavea flagrantly aimed to reduce the competitive pressure, even if it stemmed from factories in Brazil, which are buckled by the same costs as they are. While those companies with concrete investment plans tried to reason with the current administration, the association that represents the importers, Abeiva, tried to harness the political clout of former Development Minister Miguel Jorge, by hiring his consultancy, which he had founded after his stint in the second Lula administration. Mr. Jorge had, when he had still been in office in 2010, shown himself sensitive to the industry's protectionist demands. Now, as a hired gun, his consultancy aimed to ease the access for foreign imports by trying to alter the IPI-increase in the importers' favor. The importers at least managed to galvanize the opposition of the Northeastern Brazilian states against the legislation. The governors of Bahia and Pernambuco both alleged the government of favoring the Southern regions, where 46 of the 49 Brazilian car factories were situated, while the sudden rise in the IPI-rates would deprive the North from future investments by foreign car makers (Ibid). But this intervention in November and December evidently came too late, as the legislation had already been promulgated and enacted overnight in September.

Just a month after the changes had been introduced the auto parts industry bewailed the fact that the production of cars had decoupled from that of the auto parts. A study by the car importers' lobby, Abeiva, corroborated that the share of imports from the members of Anfavea increased from 17% to 22.3% since the introduction of the policy (*Valor Econômico*, 13 December 2011). The trade deficit of the industry was projected to increase even further over the next years. Thus Sindipecas continued to lobby for a change of the formula with which the car makers ought to calculate their local content. Sindipecas urged the government to apply the 65% local content requirement as a share of the costs incurred in the production process by the assemblers and not use the prices for cars as the baseline. Using the gross revenues as the baseline for the calculation of the local content rule allowed the automakers to also include marketing costs thus reducing the need for actual content of domestically manufactured car components in their calculations, to qualify for the reduction of the IPI rate (*Valor Econômico*, 17 November 2011). In April 2012 the government picked up on the arguments of the

auto-parts industry by echoing the exact same logic that Sindipecas had been voicing over the past months. It declared that the policy did not make sense, as the assemblers could include spending on "manpower, advertising and public relations", to fulfill the local content quota (*Exame*, 4 April 2012). Subsequently the government has decided to relinquish the local content rule. Instead it now reduces the level of taxation for cars by a gradual approach. The higher the costs incurred by purchasing domestic car components or raw materials, the higher the tax deduction for the cars. Now the companies will have to submit their cost sheets to the government, which will assess how much the car makers spent on domestic components, apply a weighting index for the purchased car parts and then calculate the tax rebates for the different car producers (*Exame*, 4 April 2012; Roland Berger 2012, 29). But even this tweaking of the existing rules has not yielded a turnaround for the producers of car parts. Parts from East Asia are still outstripping their Brazilian counterparts in terms of quality and pricing. Hence the trade deficit has inexorably increased over the past years, despite the government initiatives to shore up the market share of the domestic producers. While Sindipecas' president now faults the laggard surveillance over the imported parts, allowing the automakers to circumvent the local content rules, the association is left projecting ever-increasing records of their trade deficit and lay-offs linked to the imports flooding into Brazil. Although the government announced in 2013 to improve the traceability of the imported car parts, the auto parts makers are still waiting for the implementation of a thorough data collection program that would allow the government and the industry to enforce the local content rule (*AMS*, 9 September 2014).

Conclusion regarding the policies in Brazil's car industry

The positioning of the Brazilian car industry is in striking difference to its preferences in the decades before the liberalization. In those years, it had tolerated the high prices of the steel producers, whereas now it railed against unjustified price hikes and actively lobbied the government to wrest pricing power from the oligopolistic domestic steel conglomerates. It prioritized the liberalization of the steel imports on its political agenda to benefit from the steel supply glut coming from China. The availability of imports were also seen as a way to break or at least dilute the steel cartel and increase the car industry's purchasing power. The Brazilian government - caught between the volley of accusations between the steel and the car industry - consistently vacillated between liberalizing and protectionist policies and jettisoned the policies if the protests form the opposing side became too strong.

But just like in the other, above described case studies the lobbying of the car parts industry can be described as Janus-faced. While it cried out against the protectionist bouts in the steel industry, it did not hesitate to jump on the protectionist bandwagon, when its customers, the car assemblers were granted trade restrictions. As the car assemblers had been placated by the indirect increase of custom duties, they could hardly fend off the request for increasing the share for the local content rule. So far, this rule has failed to stem the constant decline of the industry's competitiveness as the net imports

continue to go upwards. At the same time, the local content rule reduced the competitiveness across Brazil's car complex. The success in erecting import barriers of the car parts manufacturers translates into increased costs for the car assemblers which are subsequently saddled with yet another pricing disadvantage over their East Asian competitors. As the car industry had beforehand been compensated with the uptick in import barriers, the episode goes to show that there is still a potential for an escalating protectionist race, wherein the respective domestic industries would become their own worst enemies. In the words of Rivoli (2009) there is a threat that the "narrow successes of each step in the value chain in keeping foreign competition at bay could, collectively, imperil" rather than improve the industries competitiveness.

4. Conclusion

Overall the governments in both countries have shown themselves very responsive to the lobbying attempts of the different industries. While the domestic industries have contributed to consolidate the trade liberalization of the 1990s, they have also compounded the problem of an exemption and loophole-ridden trade regime that has been the outcome of the bickering over and the tinkering with the trade regime policy regime by the different industries. Moreover the industries –consistently besieging the governments - have torpedoed various trade agreements and scuppered the incipient attempts of the governments to embark and embrace a cohesive trade policy. In some industries the government blundered into a series of trade mishaps that kept the domestic industries off balance, disheartened potential investors and failed to orient the decisions of the economic actors.

Overall the passivity of the governments and the lack of a comprehensive goal or strategy have led to the fact that both Brazil and India remain relatively closed economies. Sadly both countries' economies could use the infusion of productivity and spurs in innovation, which usually accompany the opening of economies through the increased availability of better intermediate goods, capital goods and the daunting loss of competitiveness that prod the industries to continuously improve their performance.

Whether they will embark on a spree of politically challenging, truly liberalizing reforms will depend on other factors. The dissertation project places hope on the unrest and dissatisfaction within the population over the stalling growth in the emerging markets and the lag in the employment creation by the manufacturing industries that could entice the governments. This could nudge the government to conduct a thorough overhaul of the trade regime in both countries, similar to the episode in the 1990s, when the countries had emerged from bouts of hyperinflation and balance-of-payment problems. This would also grant the broad population purchasing power, thus reinvigorating the economic growth in both countries.

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