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**EXTERNAL TRADE POLICY IN BRAZIL IN THE CORPORATE  
PERSPECTIVE**

**THE EXPERIENCES OF VOLVO DO BRASIL WITHIN THE HEAVY  
DUTY VEHICLE INDUSTRY**

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## **Abstract**

In this thesis, we examine the trade development in Brazil, the future trade agreements and what opportunities this might imply to the Heavy Duty Vehicle industry. To accomplish this, we take a central perspective approaching with the specific case company Volvo do Brasil and the company's interest in the future trade negotiations under discussion.

With the background and development of international agreements in Brazil, together with Volvo's interest in HDV industry we have formulated the following purpose:

***How will the development of International Trade Agreements of Brazil affect Volvo do Brasil's business with in the Heavy Duty Vehicle (HDV) industry?***

The combination of identified theoretical frameworks and one model created were useful in this process. The economic integration theories as well as multilateralism, regionalism and bilateralism concepts were important to identify and explain the development of Brazilian international agreements. The instruments applied in trade policies such as trade barriers gave knowledge with the intention to understand how the trade policy of Brazil has changed during last years and get an overall picture of current situation and the actual role of the regulatory framework. When it comes to the structural relationships of the principal actors' model, it created a link amongst the principal actors; how the company develops and modifies its strategy according to the current and future government policy, trends in the changing pattern of trade and economic integration of the countries. Besides, it brought the opportunity to identify the important consequences for the Brazilian HDV industry.

The scenario planning helps the companies to view the strategic decision in the description of each scenario. We have created four scenarios from this framework, which represent specific opportunities and threats to Volvo do Brasil by searching for characteristics that ultimately determine the future of trade negotiations.

**Key words: Volvo do Brasil, Bilateral and Multilateral agreements, Regional Integration, Brazilian Trade Policy, Heavy Duty Vehicle industry**

## Acknowledgements

*“Good is the enemy of great and that is one of the key reasons why we have so little that becomes great”*

*Jim Collins*

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Marina Gireva

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## TABLE OF CONTENTS

<b>1. INTRODUCTION.....</b>	<b>1</b>
1.1 Background.....	1
1.2 Volvo Group.....	2
1.2.1 <i>The Group</i> .....	2
1.2.2 <i>Volvo Truck Corporation</i> .....	3
1.2.3 <i>Volvo Bus Corporation</i> .....	4
1.3 Purpose and Problem Analysis.....	5
1.3.1 <i>Research Problem</i> .....	5
1.3.2 <i>Research Question I</i> .....	6
1.3.3 <i>Research Question II</i> .....	6
1.3.4 <i>Purpose</i> .....	7
1.4 Delimitations .....	7
1.5 Outline of the study .....	8
 <b>2 METHODOLOGY .....</b>	 <b>11</b>
2.1 The Research Approach .....	11
2.1.1 <i>Research design</i> .....	11
2.1.2 <i>Research strategy</i> .....	12
2.1.3 <i>Scientific Reasoning</i> .....	14
2.2 Data collection.....	15
2.2.1 <i>Primary data</i> .....	15
2.2.2 <i>Secondary data</i> .....	17
2.3 Quality of research .....	18
2.3.1 <i>Validity</i> .....	18
2.3.2 <i>Reliability</i> .....	19
2.4 Scenario method .....	20
2.4.1 <i>Overview</i> .....	20
2.4.2 <i>Scenario process</i> .....	20
 <b>3. THEORETICAL FRAMEWORK.....</b>	 <b>23</b>
3.1 Economic integration .....	23
3.2 Multilateralism .....	25
3.2.1 <i>Brazil in the WTO</i> .....	26

3.3 Regionalism .....	26
3.3.1 <i>Regional integration of Brazil</i> .....	29
3.3.1.1 <i>LAIA – ALADI</i> .....	29
3.3.1.2 <i>Mercosur</i> .....	31
3.3.1.3 <i>Free Trade Area of Americas (FTAA)</i> .....	33
3.4 Bilateralism.....	34
3.5 Trade barriers: tariff, non-tariff .....	34
3.5.1 <i>Tariffs</i> .....	35
3.5.2 <i>Non-tariff barriers</i> .....	35
 4. <b>EMPIRICAL STUDY</b> .....	 41
4.1 Overview of Brazil .....	41
4.2 Case company - Volvo do Brasil.....	43
4.2.1 <i>General description</i> .....	43
4.2.2 <i>Volvo do Brasil Strategies</i> .....	45
4.3 Automotive industry .....	46
4.3.1 <i>Global trends</i> .....	47
4.3.2 <i>Brazilian automotive industry</i> .....	47
4.3.3 <i>Brazilian Heavy Duty Vehicle industry</i> .....	50
4.4 Trade policy and main trade partners .....	54
4.4.1 <i>General Description</i> .....	54
4.4.2 <i>Trade barriers</i> .....	56
4.4.3 <i>Trade and main trade partners regarding HDV industry</i> .....	60
4.5 Brazilian International Trade Agreements .....	68
4.5.1 <i>LAIA-ALADI</i> .....	68
4.5.2 <i>MERCOSUR</i> .....	69
4.5.3 <i>International agreements negotiated by Mercosur in Latin America</i> .....	72
4.5.3.1 <i>Chile</i> .....	72
4.5.3.2 <i>Bolivia</i> .....	73
4.5.3.3 <i>Mexico</i> .....	73
4.5.3.4 <i>Andean Group (Community)</i> .....	74
4.6 Future Trade Agreements under Negotiation .....	76
4.6.1 <i>Multilateral agreements</i> .....	76
4.6.1.1 <i>Free Trade Area of the Americas (FTAA)</i> .....	76
4.6.1.2 <i>Mercosur – EU</i> .....	78
4.6.2 <i>Bilateral agreements</i> .....	83
4.6.2.1 <i>Brazil - India</i> .....	83



4.6.2.2 <i>Brazil - China</i> .....	84
4.6.2.3 <i>Brazil - South Africa</i> .....	86
<b>5 ANALYSIS</b> .....	<b>89</b>
5.1 General Overview of the Main Problem .....	89
5.2 Evaluating the outcome from the relationship of the principal actors .....	90
5.2.1 <i>Government policy</i> .....	91
5.2.2 <i>Regional Integration, Multilateral and Bilateral agreements</i> .....	92
5.2.3 <i>Effects on Volvo do Brasil strategies</i> .....	95
5.3 Scenarios.....	97
5.3.1 <i>Scenarios' outlook</i> .....	97
5.3.2 <i>Scenario I – “Affirmative Actors”</i> .....	100
5.3.3 <i>Scenario II – “Dependent actors”</i> .....	101
5.3.4 <i>Scenario III – “Asymmetric actors”</i> .....	102
5.3.5 <i>Scenario IV – “Low-scope actors”</i> .....	103
<b>6. CONCLUSIONS AND RECOMMENDATIONS</b> .....	<b>105</b>
6.1 Main conclusions on the research questions .....	105
6.2 Recommendations for the company .....	109
6.3 Area for further investigation .....	110
<b>REFERENCE LIST</b> .....	<b>111</b>
<b>APPENDIX I</b> .....	<b>119</b>
<b>APPENDIX II</b> .....	<b>120</b>

## **TABLES**

Table 3.1: Major types of trade policies pursued by government towards exports and imports .....	38
Table 4.1: Automotive trade flexibility between Argentina and Brazil in 2002/06 .	71
Table 4.2: Mercosur Import Duties in the automotive transition period 2000/06 ...	72
Table 4.3: the EU and Mercosur proposals on the negotiations regarding automotive sector .....	80
Table 4.4: Positions of ACEA and Anfavea in the negotiations .....	81

## **FIGURES**

Figure 1.1: Outline of the thesis .....	9
Figure 2.1: Research Approach.....	12
Figure 2.2: Data collection process during field-study in Brazil.....	17
Figure 2.3: Scenario development .....	21
Figure 2.4: Scenario Matrix .....	22
Figure 3.1: Levels of Regional Integration .....	23
Figure 3.2: Structure of LAIA/ALADI .....	30
Figure 3.3: Principal factors involved in the “Objective 2006” agenda. ....	32
Figure 3.4: Structural relationship of the principal actors .....	39
Figure 4.1: Automotive production by continent in 2001 .....	48
Figure 4.2: Production of all trucks and buses by main manufacturers in Brazil in 2002.....	50
Figure 4.3: Brazilian manufacturers’ market share in heavy trucks and buses segments in 2002 .....	51
Figure 4.4: Domestic production and sales of nationally manufactured trucks and buses in 1995-2002.....	52
Figure 4.5: Trade balance of Brazil versus trade balance of automotive sector in 1994-2003.....	61
Figure 4.6: Trade balance of HDV industry in Brazil in 1995-2002.....	61
Figure 4.7: Brazilian trade balance of auto-parts in 1995-2002 .....	62
Figure 4.8: Principal import markets of Brazilian HDV industry in 2001/02...	64
Figure 4.9: Principal export markets of Brazilian HDV industry in 2000/01 ...	65
Figure 4.10: Principle export and import markets of Brazilian auto-parts industry in 2002.....	67
Figure 5.1: Main problem and research questions .....	89
Figure 5.2: Structural relationship of the principal actors .....	90
Figure 5.3: Scenario framework.....	99

## **List of Abbreviations**

<b>AAP-CE55</b>	Partial Agreement Protocol of the Economic Complementation Agreement
<b>AAP-R9</b>	Partial Agreement Protocol
<b>ACEA</b>	Association des Constructeurs Européens d' Automobiles (European Automobile Manufacturers Association)
<b>AIS</b>	Andean Integration System
<b>ALADI- LAIA</b>	Asociación Latinoamericana de Integración (Latin American Integration Area)
<b>ANFAVEA</b>	Associação Nacional dos Fabricantes de Veículos Automotores (National Association of Automotive Vehicle Manufacturers)
<b>ASEAN</b>	Association of Southeast Asian Nations
<b>BNDES</b>	Brazilian Development Bank
<b>CBU</b>	Completely built up
<b>CET</b>	Common External Tariff
<b>CIF</b>	Cost, Insurance, Freight
<b>CKD</b>	Completely knocked-down: used for a bus or a truck imported in parts, for local assembly
<b>ECA</b>	Economic Complementation Agreement
<b>ECB</b>	Environmental Concept Bus
<b>ECT</b>	Environmental Concept Truck
<b>EU</b>	European Union
<b>FDI</b>	Foreign direct investment

<b>FTZs</b>	Free Trade Zones
<b>G-3</b>	Group of Three
<b>GATT</b>	General Agreement on Tariffs and Trade
<b>GDP</b>	Gross Domestic Product
<b>GM</b>	General Motors
<b>GVW</b>	Gross Vehicle Weight
<b>HDV</b>	Heavy Duty Vehicle
<b>IMF</b>	International Monetary Fund
<b>MERCOSUR</b>	Southern Cone Common Market
<b>MFN</b>	Most Favoured Nation
<b>MIDP</b>	Motor Industry Development Programme
<b>MNCs</b>	Multinational Corporations
<b>NAAMSA</b>	National Association of Automobile Manufacturers of South Africa
<b>NAFTA</b>	North American Free Trade Agreement
<b>PAM</b>	Mercosur Automotive Policy or Common Policy
<b>PROSEC</b>	Programme of Sectoral Promotion
<b>RTAs</b>	Regional Trade Agreements
<b>SECEX</b>	Brazilian Foreign Trade Secretariat
<b>SINDIPECAS</b>	Sindicato Nacional da Indústria de Componentes para Veículos Automotores (National Association of Auto-parts Manufacturers)
<b>SISCOMEX</b>	Foreign Trade Integrated System

<b>UN</b>	United Nations
<b>US</b>	United States
<b>VBC</b>	Volvo Bus Corporation
<b>VdB</b>	Volvo do Brasil
<b>VG</b>	Volvo Group
<b>VTC</b>	Volvo Truck Corporation
<b>VW</b>	Volkswagen
<b>WTO</b>	World Trade Organisation



## 1. INTRODUCTION

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*This chapter illustrates the background and purpose of the thesis as well as our research questions. It also includes a description of the Volvo Group's present activities in South America. To conclude this introduction chapter we present the delimitations, which establish the bounds of our thesis, and outline of the study.*

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### 1.1 BACKGROUND

In the 1990's, the South American countries progressed in search of union with their neighbours, driven by the understanding that staying independent in an increasingly competitive and global market, where other economies, both big and small, have been organising themselves into trading blocs, would lose marked opportunities. The reaction associated with a more open business environment across the region, turned many proposals that had been under discussion since the 1960s into reality.<sup>1</sup>

When it comes to the regional integration, it offers the possibility for many critical actions, for example, to consolidate regional markets in the context of an overall opportunity to the world trading system, to promote regional infrastructure as well as to strengthen institutions for integration, etc. It is also a tool for achieving a set of development goals and objectives taking advantage of the globalisation process in order to promote sustainable economic growth and poverty reduction. As part of the regional integration, there are some achievements and deficiencies as well.<sup>2</sup>

The Asociación Latinoamericana de Integración (ALADI) or Latin American Integration Area (LAIA) composed of Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Cuba and Venezuela, the Group of Three (G-3) comprised by Mexico, Colombia and Venezuela, the Southern Cone Common Market (Mercosur), a broad trade agreement signed by Brazil, Argentina, Uruguay and Paraguay, etc. have been the most visible results of this new trend. Moreover, a network of either bilateral or multilateral trade agreements has changed over the recent past to allow free commerce within the region. At the same time, these agreements are increasingly being

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<sup>1</sup> Hartford Web Publishing (1998)

<sup>2</sup> Inter-American Development Bank (2003)

extended, new developments are being made and a greater number of countries from different continents are establishing links with South America.<sup>3</sup>

This new political and economic environment has been significantly reshaping the South American automotive industry and within it the heavy duty vehicle (HDV) sector. According to the new regional areas of influence, manufacturers have been investing in broader operations, rationalising investment and creating new market opportunities. However, imbalance between countries, particularly in import duties, tariff/non-tariff barriers, etc. has led to certain pressure to some extent. Nevertheless, the South American automotive industry as a structure has made more sense to manufacturers, with the result that it has already been modernised, enhancing quality and competitiveness in the process.

Volvo do Brasil (VdB), being one of Volvo Group's subsidiaries with presence in Brazil, has been a witness to these international trade agreements and their effects on its HDV operations. When it comes to the future negotiations regarding trade agreements, VdB, as well as other competitors, is interested in the ongoing processes and the outcome concerning new markets, lower import duties, tariffs, etc. As the countries change and adapt to a more integrated economic system including free trade areas, etc., these markets and trade negotiations become more and more attractive for VdB's business.

## **1.2 Volvo Group**

### **1.2.1 The Group**

The Volvo Group (VG) is one of the global leading manufacturers of buses and trucks as well as construction equipment, propulsion systems for marine and industrial applications, and aerospace components. VG also provides certain amount of services including financing, leasing, insurance, after-sales services, warranty, rentals and services. It has operations in over 125 countries with more than 70 thousand employees and 62 plants in over 27 countries.<sup>4</sup>

The principal business areas are: Volvo Trucks, Mack Trucks, Renault Trucks, Volvo Buses, Volvo Construction Equipment, Volvo Penta, Volvo Aero and Volvo Financial Services, in addition it offers manufacturing development (IT

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<sup>3</sup> SICE

<sup>4</sup> Volvo do Brasil (2003), Volvo Group Web site (I)



solutions), logistical, and components support. The Volvo Group occupies a strong position as a car producer in their segment of the market. In year 2002, the VG net sales amounted to EUR19 333 million. The distribution of the sales by market in year 2002 was principally Europe with 56% and North America with 28%, in the case of *South America*, only 3%. The Volvo units in *South America*: VdB with trucks and buses manufacturing and financial services in Curitiba, Paraná state, also the Volvo Construction Equipment located in Pederneiras, Sao Paulo with construction equipment manufacturing and Volvo Penta located in Rio de Janeiro. There is a Mack's truck manufacturing plant in Venezuela and Volvo Sudamericana S.A.C.I. (Buenos Aires) with truck manufacturing.<sup>5</sup>

### **1.2.2 Volvo Truck Corporation**

The Volvo Truck Corporation (VTC) is one of the leading global heavy truck brands. It offers trucks and complete transport solutions. The company owns nine assembly plants around the world and one is located in Curitiba, Paraná State, Brazil.

VTC has chosen a strategy of multi-brand operations and acquired Renault Trucks and its subsidiary Mack Trucks in the USA in 2001. Today VTC represents three business units, three brands of Volvo, Mack and Renault. Renault Trucks, a European manufacturer, offers a wide range of trucks from light commercial to heavy trucks and market share in Western Europe in heavy trucks segment (over 16 tons) constituted 13.2% in 2002. Mack Trucks, one of the biggest heavy trucks manufacturers in the North America, operates in medium and heavy trucks segments and obtained a market share of 13.4% in 2002. The production of Mack trucks was transferred to the Volvo plant in the USA and as a result, both brands are currently assembled in one site. The programmes of rationalisation and efficiency enhancement were implemented by VTC in order to achieve synergies during integration.<sup>6</sup>

Within the leading worldwide manufacturers of heavy trucks in year 2002 VTC obtained the third position with 119 000 units, Mercedes Group and Chinese First Automobile Works (FAW) in first and second positions, respectively. The VTC' sales are more than 90% trucks in heavy weight class over 16 tons. When it comes to the leading markets, Europe took the first position with US\$8 349

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<sup>5</sup> Volvo do Brasil (2003), Volvo Group Web site (I)

<sup>6</sup> Volvo Truck Corporation

million, North America US\$4 173 million, Asia US\$732 million, *South America* US\$405 million and other markets US\$990 million. Regarding technology, Volvo Trucks is working with continued innovations for minimising environmental impact, the Environmental Concept Truck (ECT) is example of it.<sup>7</sup>

### **1.2.3 Volvo Bus Corporation**

The Volvo Bus Corporation (VBC) is the world's second largest bus manufacturer having an entire variety of heavy buses to meet the customers' requirements for passenger transport solutions. The product range includes complete buses and coaches as well as chassis. Volvo Bus' operation has a global presence, with production in Europe, North and South America and Asia. The plant in *South America* is located in Curitiba, Paraná State, Brazil. It has created a unique position for its high capacity articulated and bi-articulated buses. VBC has changed its whole product range of city buses, intercity buses and tourist coaches in less than five years. Most of the new models are based on TX which is an advanced company's model platform for intercity buses and tourist coaches. It is the largest industrial project in the history of VBC improving the company's products to a higher technical and qualitative level. When it comes to the leading worldwide manufacturers for heavy buses in year 2002, Volvo obtained the second position with 9 060 units, Mercedes and Setra (DaimlerChrysler branch) led the list with 22 273 units. For the leading markets, Europe took the first position with US\$879 million, North America US\$474 million, Asia US\$250 million, *South America* US\$45 million and other markets US\$87 million.

The VBC, as well as VTC, is working with continued innovations and for minimising environmental impact, the new Environmental Concept Bus (ECB) is example of it. When it comes to earnings, these remained unsatisfactory; as a result, the bus capacity is being adjusted to lower demand, with a focus on Europe and *South America*. There are still regional differences in market trends worldwide. However, the tourist bus market globally remains very low, particularly in North America and Europe. The total market in Europe is weak, attributable mainly to Central Europe. The markets in Asia, Hong Kong and Singapore are still on a low level, while a positive trend is noted in China. The market is stable in Mexico. The market in *South America* is weak, but shows a

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<sup>7</sup> Volvo Truck Corporation

tendency towards recovery. Increased market activities can be noted in most regions. VBC is continuing to implement an intense programme to achieve profitability. The focus is on Europe and *South America*, where capacity is being reduced based on current order bookings. Introductions of the global product platforms are being made in the *South America*, Mexico and Asian regions.<sup>8</sup>

## 1.3 Purpose and Problem Analysis

### 1.3.1 Research Problem

With the process of globalisation, the global market has changed due to increasing regional integration of countries. Creation of free trade areas and trade agreements between countries reduces trade barriers and leads to increasing number of open markets. This allows the companies to expand their operations, enter new markets and therefore increase competition in those regions. Brazil has developed certain number of trade agreements and the further integration is still under discussion.

The companies in Brazil will benefit from further integration of countries in South America and with other regions. This will allow them to gain advantage from favourable trade policy of countries and increase efficiency and operations if the markets are open. Volvo do Brasil, being an active player in HDV industry in Brazil, will be influenced by the changes of the integration processes and development of international trade agreements. Therefore, we formulated the following main problem:

***How will the development of International Trade Agreements of Brazil affect Volvo do Brasil's business in the Heavy Duty Vehicle (HDV) industry?***

In an attempt to answer our main problem, research questions have been developed that will help us to understand the issues shaping the main problem and perform in-depth analysis. The study will begin with the description of automotive (HDV) industry in order to give an overall picture to the reader what the present situation and main trends are in the country as our case

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<sup>8</sup> Volvo Group Web Site (II)

company operates there. Then we will follow the defined research questions to facilitate the investigation and understanding of the main problem.

### **1.3.2 Research Question I**

*Research Question I* is designed with intention to understand how the trade policy of Brazil has changed during last years and get an overall picture of the current situation. The actual role of the regulatory framework must also be investigated. The regulatory changes are considered with regard to their enforcement in business practice, especially in the automotive industry. This research question will provide the opportunity to see how Brazil reduces, and perhaps removes, some measures taken to restrict imports or support exports. With regard to the trade policies that can arise within the specific industry of HDV, the following question was raised:

*What are the main elements in trade policy of the Brazilian government regarding HDV industry?*

In addition, we will identify what main trade partners of Brazil are regarding HDV industry. It will help us to define what countries (trading blocs) are important for Brazil to develop negotiations with and create agreements where automotive industry is involved. Why the focus is put on the trade partners of Brazil in general, but not on VdB particularly, is because the government negotiates the agreements with other countries according to their importance for the whole automotive industry, but not for a certain company. This will help to move to the next research question.

### **1.3.3 Research Question II**

The second research question is intended to analyse the changes in trade agreements and what international organisations Brazil is a member of, as well as what effect and opportunities the membership brought for the country, for example, the Brazil's Mercosur membership, World Trade Organisation (WTO), etc. and the link with other regional blocs. The aim is to investigate what future negotiations will be conducted in order to determine what markets will be open in the future for free trade for VdB. Thus, the second research question was formulated as:

*What bilateral and multilateral agreements within international trade regarding HDV industry has Brazil implemented until now and what changes will arise in the future?*

We will build-up different scenarios of future trade development in Brazil considering the bilateral and multilateral trade negotiations in progress, and find out the impact of these changes in trade for Volvo business performance within the HDV industry. The scenario development will be helpful to investigate the main problem. Moreover, these scenarios will provide Volvo with increased awareness of ongoing and future trends within the area.

#### **1.3.4 Purpose**

Within the development of trade in Brazil as well as Volvo's current activities in the region, the principal objective of this study is to investigate, assess and evaluate the impact on VdB of a changing trade-policy environment including regional economic integration. We will describe the Brazilian HDV industry and focus on trade policy of the country and regional economic integration of Brazil.

As VdB, develops its strategy according to external environment changes, it should monitor the integration processes that involve Brazil and other countries. The purpose of our thesis is *to identify what possible opportunities will arise helping VdB, operating in HDV industry, to improve and expand its operations conditional to the development of integration processes.*

### **1.4 Delimitations**

In order to have the emphasis on the right aspects in the thesis, various delimitations have to be made. Regarding our case company, the focus will be put to identify VdB strategy, but a study of the value-chain and strengths and weaknesses will not be conducted. In the trade policy, we will investigate the main trade barriers applied only in HDV industry. When it comes to trade agreements, the regional economic blocs that Brazil is not member of are not covered. We are not going to give an in-depth analysis or evaluation of the HDV industry in Brazil, an overall description will be presented in order to introduce the current status of the industry to the reader. Furthermore, the HDV

industry development in the countries that are main trade partners of Brazil is not described.

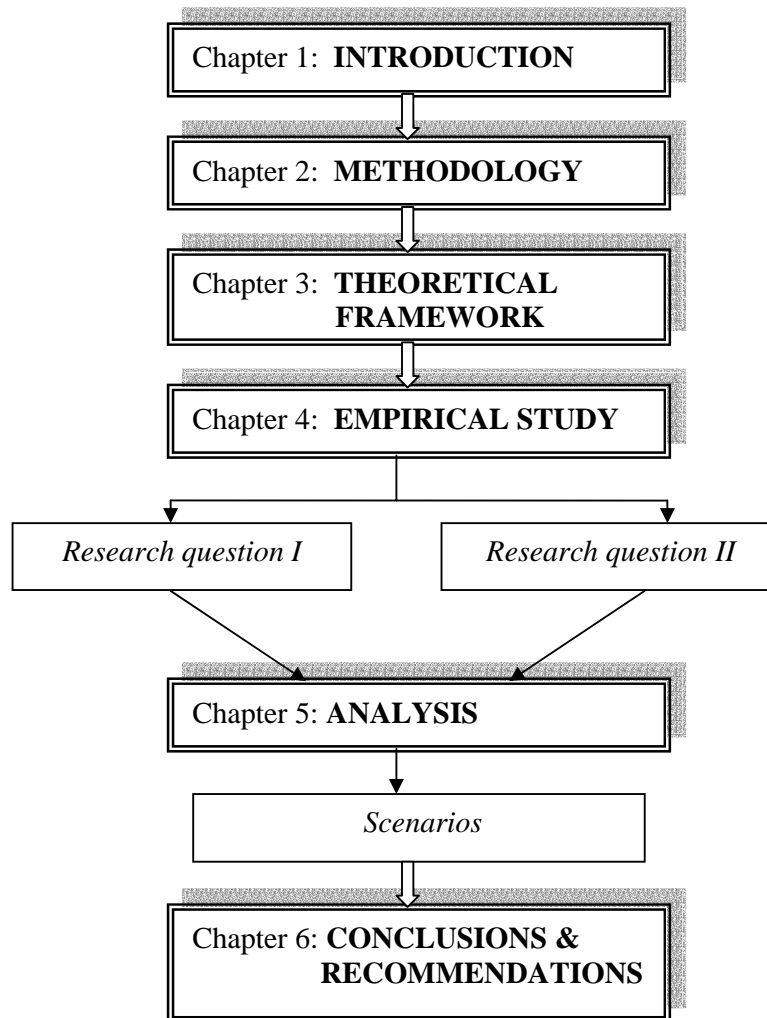
Besides, considering the bilateral and multilateral trade negotiations in progress the scenarios platform will be up to five years. Since most of the future negotiations have not been concluded and they are still under discussion, tariffs and non-tariff barriers are not established yet within these agreements. As a result, the description of the scenarios will be based considering this aspect.

Since it was difficult to define the completely knocked down units (CKDs) separately, the investigation was conducted about auto-parts in general, as CKDs are included in the auto-parts statistics.

## **1.5 Outline of the study**

This paper consists of six chapters and the *Figure 1.1* demonstrates the structure of the study. We have started with the introduction, followed by methodology describing how the investigation was conducted, and theoretical chapter, presenting various theories and models used in order to answer our main problem and research questions. The empirical findings are demonstrated in the next chapter, where research questions are discussed. Further, as part of the analytical phase, the scenarios will be presented. Finally, the chapter covering conclusions and recommendations will end our thesis.

**Figure 1.1: Outline of the thesis**



*Source: Authors' elaboration*





## 2 METHODOLOGY

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*This chapter explains how the study was organised. It begins with a description of the research approach and strategy followed by an explanation of the case study strategy and the scheme of the data collection. We evaluate our data by discussing the quality of our research and finalise this chapter describing the method of developing scenarios.*

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### 2.1 The Research Approach

#### 2.1.1 Research design

The research design is the “overall plan for relating the conceptual research problem to relevant and practicable empirical research on gathering the information needed to answer the research problem under scrutiny”. Also, the research design is an approach which helps to answer the research problem in the best possible way considering certain limitations. It is the choice of the best way how to conduct research and what information is needed to collect to answer the research problem. Research design depends on what problem is investigated, if it is structured or not. According to Ghauri and Gronhaug, there are three main research designs: exploratory if the problem is unstructured, descriptive and causal if the problem is structured. When it comes to the *exploratory research design*, it is characterised by the flexibility and more useful when the problem is poorly understood. The explanatory case studies use the available data to explain a particular phenomenon. In case of structured and well understood problems, the *descriptive research* is appropriate which requires well prepared procedures such as interviews, sampling plans, etc. The *causal research* deals with problems of “cause-and-effect”, where it is necessary to investigate the influence and effects of one, two or more factors.<sup>9</sup>

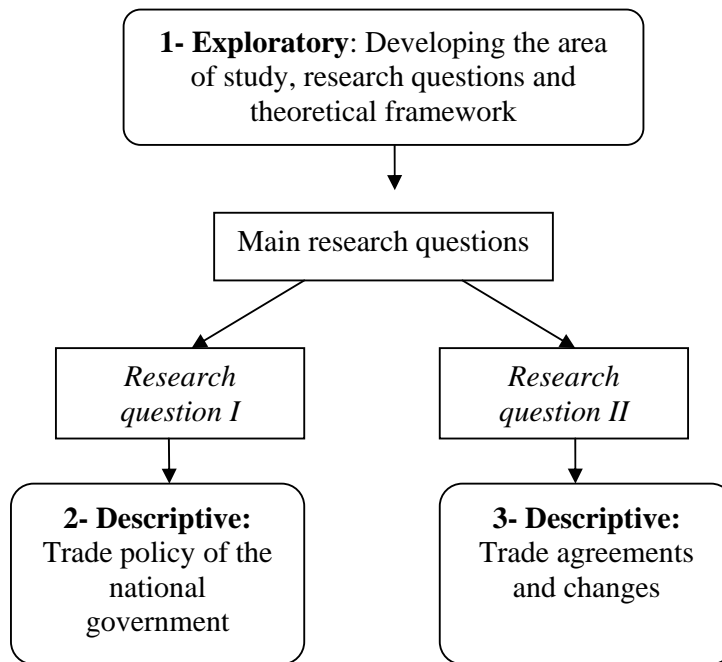
As we described before, we have our main problem as well as the two research questions approaching the final analysis and conclusion of our thesis. The different questions have different methodological research strategies. The main problem of our thesis, “***How will the development of International Trade Agreements of Brazil affect Volvo do Brasil’s business in the Heavy Duty Vehicle (HDV) industry?***”, has an exploratory approach presented as a case

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<sup>9</sup> Ghauri P. et al. (1995), Yin, R.K (1994).

study. When it comes to the research questions, they have the structure of descriptive approach, while scenario building for the future, relates to the main problem with exploratory approach. The following *Figure 2.1* shows summarised research approach.

**Figure 2.1: Research Approach**



*Source: Authors' elaboration*

### 2.1.2 Research strategy

There are mainly five types of strategies to be considered when conducting social science research: experiments, surveys, histories, archival analysis and case studies. Each strategy represents a different approach to treat a determinate problem and consequently each one has advantages and disadvantages.<sup>10</sup> The appropriate selection should be based on the problem statement and the expected results. Furthermore, it is important to take into consideration the type of research questions that are established, the extent of control the researcher has over actual behavioural events and the contemporary or historical nature of the event.<sup>11</sup>

<sup>10</sup> Yin, R.K (1994)

<sup>11</sup> Merriam, S.B. (1998)

### **Case study**

The case study can be defined as “*an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between the phenomenon and the context are not clearly evident.*”<sup>12</sup>

The case studies are applied in many different situations, amongst them writing thesis and dissertations in the academic world and in other professional fields such as business administration and management. It is important that when undertaking a case study the limiting boundaries are well established. If the event studied is not limited, the strategy chosen will not be a case type. This can be done by limiting the data collected or the number of interviewees.<sup>13</sup>

Moreover, the case studies are normally employed when the research questions posed are “how” and why”, when the researcher has little control over the events and when contemporary events in a real life context are in focus. The investigations conducted under this approach will maintain a broader perspective retaining the key characteristics of a real-life situation. By studying different aspects of a phenomenon and their interrelations with one another, it is possible to observe the total environment using the researcher capacity. In this respect, case studies provide a holistic view of the process examined. Usually, the data collection for case studies is obtained through long and rather unstructured interviews but also combining it with secondary data.<sup>14</sup>

There are three main rationales to undertake a single case study. Firstly, the *critical case* when the objective is to test a well-formulated theory in order to confirm, challenge or extend that particular theoretical framework. Secondly, the *extreme case* which investigates a unique or rare event, and thirdly the *revelatory case* referring to events that have not yet been scientifically studied. Additionally, it is necessary to determine the type of unit in which the study will be based on. A holistic design will concentrate on a single unit of analysis in order to evaluate the global nature of the event, while on the other hand the embedded design will evaluate several units or sub-units of the same phenomenon.<sup>15</sup>

This thesis follows a single case design based in the revelatory rationale. As stated in our purpose, it is our goal to investigate, assess and evaluate the impact of regional economic integration and the effect for VdB, also there are

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<sup>12</sup> Yin, R.K (1994)

<sup>13</sup> Merriam, S.B. (1998)

<sup>14</sup> Yin, R.K (1994)

<sup>15</sup> Ibid

some theories will help to make the assessment. When it comes to the type of unit on which the study will be based, our case study is, as mentioned before, a single study with an embedded design. We started the thesis by setting up a preliminary outline. Then, a pre-study was conducted to create a frame of reference, purpose, etc. In our case study of Volvo do Brasil operating in HDV industry, the embedded units are the trade agreements that we selected based on the pre-study.

### **2.1.3 Scientific Reasoning**

In order to approach a particular problem, a researcher has the possibility to start from either theoretical or empirical level. In this respect, there are three ways of reasoning when examining a particular problem: the deductive, inductive, and abductive reasoning, which will be presented in the following section. The theoretical level is the point of departure of the *deductive* reasoning, meaning that by using general principles and theories that are later on tested in an empirical study in the form of hypothesis, it will be possible to produce logical conclusions regarding a particular phenomenon. Contrary, the *inductive* approach begins from the empirical level by gathering first empirical data to thereafter produce conclusions and develop theories. The combination of these two approaches derives from what is known as an *abductive* approach. This is considered a rather convenient and effective reasoning, since a researcher, by making use of both established theories and empirical evidence, is able to construct his own theoretical models.<sup>16</sup>

In the initial stage of this thesis a deductive approach was used in order to determine the area of study to focus on. Thereafter, several articles, journals, books, etc. were revised in order to establish the specific interest as well as to gain deeper knowledge of the subject. The current theory to be applied in our case showed us that there was a lack of an integrated theoretical framework. The latter was more in general aspects of description, in this respect, the next reasoning employed was an inductive approach where the theories presented served as the base to create our own theoretical model in order to obtain the interdependencies between the actors analysed.

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<sup>16</sup> Merriam, S.B. (1998)

### ***Qualitative Method***

Qualitative methods have the main goal to understand the inner situation in which a particular phenomenon is situated as well as the way in which all the individual parts are interrelated conforming the whole part. The nature of the qualitative method is mainly inductive, putting into focus the processes rather than the outcomes, but also stressing to some extent the importance of description and interpretation. In this way, it is possible to create a deeper and complete understanding of the situation examined, where the researcher is an instrument for the collection and analysis of the data. The qualitative methods are deep and partly unstructured allowing a more flexible relationship with the interviewees which results in a deeper and enriched understanding of the situation's context. We used this method in the analysis of the trade policies, tariffs and HDV statistics and for the international trade agreements. This study was conducted from an exploratory approach since the aim is to identify, define and structure a particular problem.<sup>17</sup>

## **2.2 Data collection**

During the process of investigation the data was collected from different available sources. It includes all the materials needed in order to conduct investigation. There are two major alternative sources of data which are defined as primary data and secondary data. In our case, both types were used in order to increase validity, as the data given by different sources can vary to some extent. If there is a possibility, it is beneficial to confirm the data provided by various sources.

According to Yin, 1994, the data can be collected from the following sources: documents, archival records, interviews, direct observation, participant observation and physical artefact.<sup>18</sup>

### **2.2.1 Primary data**

The primary data was collected by the researchers and for the specific purpose of investigation. The data collection was implemented through personal interviews and direct observation. Interviews are the most important source of information and the first interviews were performed at Volvo in Gothenburg in order to get an overall picture of operations in Brazil. To facilitate a deeper understanding of the on-going processes, the field-trip to Brazil was made. In

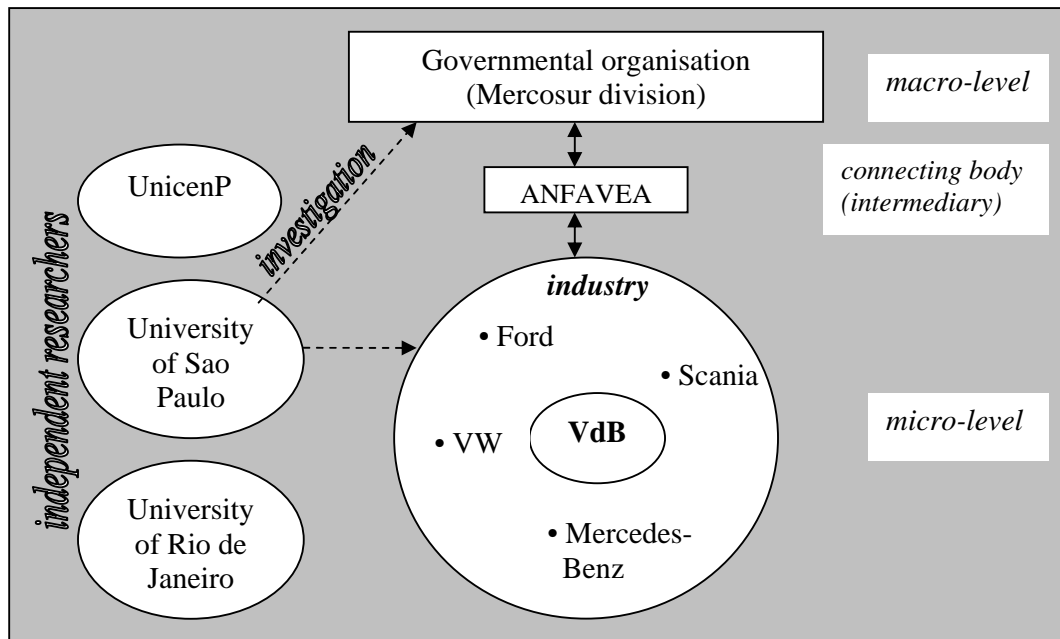
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<sup>17</sup> Merriam, S.B. (1998)

<sup>18</sup> Yin, R.K (1994)

the following *Figure 2.2*, the scheme of our interviews is presented explaining what approach has been chosen to collect the information. It gave us a better understanding of the problem from different perspectives, looking at the viewpoints of the government involved in the negotiations and processes of integration, from macro-level, followed by companies or major actors in the industry, which represent micro-level and from independent observers, represented by academicians that conducted research in this area.

The interviews that were conducted in VdB provided us with the knowledge of main issues regarding the company performance. In addition, we found it useful to interview other main players in the HDV industry in order to understand what the main problems a vehicle manufacturer in Brazil meets with exports and imports. Hence, we tried to find out what other potential threats can arise for VdB. Other interviews were conducted at the governmental level, which in our case was Mercosur division. This helped us to collect the data about the processes of Mercosur countries' integration, how it works and what future objectives they try to achieve. It was also helpful to understand how co-operative the government is with the industrial sector, and what future negotiations outside Mercosur are expected to take place. The National Association of Automotive Vehicle Manufacturers (Anfavea), a connecting body between government and main players of automotive industry is presented in the *Figure 2.2*, where interviews were also conducted. It is represented by the industry, as the members are vehicle manufacturers; thus it represents interests and problems of the industry and, at the same time, deals with the government and knows its directions and policies. Besides, it was helpful for us to learn the point of view of the academic researchers who investigated the issue of automotive industry development and integration processes of the country. Therefore, some interviews with professors from University of Sao Paulo, Rio de Janeiro and UnicenP - University in Curitiba were conducted.

**Figure 2.2: Data collection process during field-study in Brazil**

Source: Authors' elaboration

According to Merriam (1998) there are different forms of interviews depending on a structure: structured (standardised) and unstructured (informal) interviews.<sup>19</sup> In our investigation, we used a semi-structured form of interview, where a set of questions was prepared derived from the investigated matter, and in addition, a personal opinion about events and situations was taken note of. This form also allows asking additional questions that arise during conversation and makes the conversation more flexible.

The field-trip allowed us to conduct direct observation in order to have a personal perception of the studied situation. We have observed the situation of trucks and buses market, what brands are frequently met, the level of usage and the conditions of roads in Brazil. The intercity buses and coaches conditions and services were also observed since some trips were taken by this means of transport.

### 2.2.2 Secondary data

Secondary data has been largely used during our research. These include books, articles, statistics publications, magazines, newspapers, reports and other

<sup>19</sup> Merriam, S.B. (1998)

sources. The main sources of literature were obtained from Gothenburg University Library, Volvo Library in Gothenburg, Volvo Intranet and Internet.

The main disadvantage of the secondary data is that it was previously collected by other investigators for different purposes. Also, some data might not be updated; however, it is easier to collect with low costs.

Despite all advantages and disadvantages of the secondary data, it helped us to understand the main issues regarding our research questions. This facilitated a good background to the main trends in Brazilian trade development and historical development of trade policy in the country. It also provided the knowledge of the main problems in the automotive sector, which were obtained from the various articles.

## **2.3 Quality of research**

The quality of the investigation increases if the validity and reliability are assured. In order to conduct a reliable investigation, certain steps should be taken to test the research findings. It is important to keep in mind that mistakes might affect the results of investigation and the data collected should be evaluated.

### **2.3.1 Validity**

Validity is one of the measures to be checked. Merriam identifies two ways to test validity including external validity and internal validity.<sup>20</sup> Internal validity deals with the reality of the findings and how these findings reflect the reality.

During our investigation and collection of data, we tried to use as many possible sources in order to improve and broaden the perspectives of the investigated issue. When conducting interviews, it is important to clarify all issues to have a better understanding. The questions should be simple for a better interpretation by a respondent. If the answers of different respondents are similar, it indicates that the validity becomes higher. In our case, most of the interviewees had a similar perception of the investigated issues. The respondents, with the help of VdB, have been carefully chosen and selected to be experts on the matter to improve the quality of the collected information. All the doubts regarding particular issues or their interpretation were clarified by

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<sup>20</sup> Merriam, S.B. (1998)



sending additional questions to the respondents when the field-study was over. In addition, during interviews, we used a tape-recorder which gave an advantage to restore information missed while taking notes. All these points helped us to enhance the internal validity.

External validity deals with the problem if the findings can be generalised beyond the immediate case study.<sup>21</sup> It can be said that it is possible to apply our study to other vehicle manufacturers active in Brazilian automotive industry. Also, the developed scenarios of future integration can be generalised for all other companies in Brazil. However, the effects of these future scenarios can only be relevant for VdB, since they are specific for a particular case company acting in a certain industry.

### **2.3.2 Reliability**

The main purpose of reliability in the research is to avoid errors and biases. Reliability can be tested if the same case is done over again by another investigator and, if he comes to the same findings and conclusions.<sup>22</sup> However, it is obligatory that another researcher should follow exactly the same procedures, taken by the previous one, and the investigation should be made at the same time. The latter requirement strongly applies to our case since the findings can change over the time and specifically the issue of integration process and negotiations under discussions. With every negotiation meeting between the governments certain agreements are achieved in the discussions and implemented or postponed. Thus, if our case is conducted at a different time, the results will alter.

In order to increase reliability of our case and the data presented, we put all efforts into selecting the information from trustworthy sources. To facilitate the reliability of secondary data, various sources were used. That is why the statistical data was collected from different institutions and compared as to whether there were variations. Before conducting interviews, some investigations had been made and secondary information had been collected in order to be prepared to discuss the issues touched upon in the interviews. In addition, the facts that had been mentioned by respondents were checked by asking the same questions of other competent people in this area as well as by searching for other sources in order to support their statements. The discussed

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<sup>21</sup> Yin, R.K (1994)

<sup>22</sup> Ibid

matters at the interviews were put down on paper directly after the interviews took place.

## **2.4 Scenario method**

### **2.4.1 Overview**

After describing the actual HDV industry in Brazil and the trade policies as well as the Brazilian international agreements, it will be necessary to present different approaches for the scenario strategy development. This approach creates a need for an appropriate analysis process that can lead us through the empirical material in order to find the tendencies that point out the future development of the bilateral or multilateral negotiations.

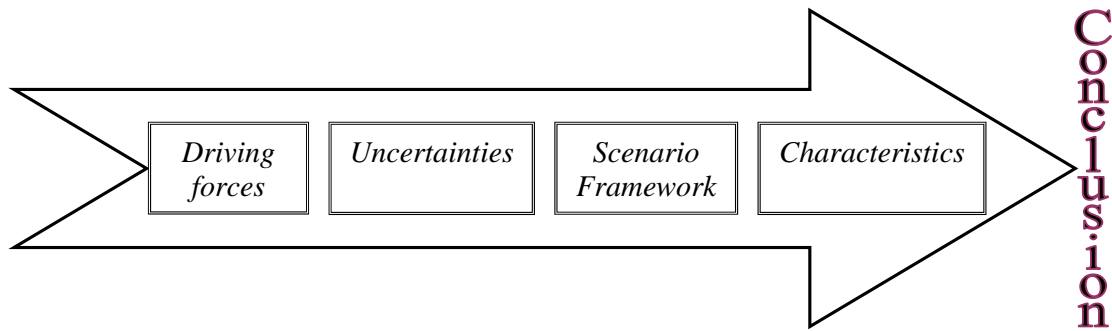
The learning benefits of scenario planning require close attention to the process. A careful planning and structuring of the scenario development, synthesis and evaluation stages of scenario planning are needed. The details of the process will be adapted to the needs and resources available in the case. We took the extended approach, described in *Scenarios in Business* by Gill Ringland, but with overall guide found in Peter Schwartz's *The Art of the Long View*.<sup>23</sup> We have identified four principal steps in our thesis; these will be described in the next section.

### **2.4.2 Scenario process**

Our case study required a model that can comprehend the dynamic conditions of the future situation. The scenario method is able to help in that, it creates a framework in which particular uncertainties are visible. While the changes are certain, the exact form of this might be unclear. Scenario processes cannot remove the factors of uncertainty, but they have the ability to expand the knowledge to a certain extent in which decisions are tough in future situations.

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<sup>23</sup> Ringland, G. (2002)

**Figure 2.3: Scenario development**

Source: Authors' elaboration

### ***Driving forces***

In the first step, the *driving forces* identify the major forces and factors affecting the local environment that will influence the success or failure of decisions about the principal purpose of the scenarios. Sometimes these forces are identified in a macro environment aspect. The fundamental characteristics of the driving forces are then examined in order to provide a complete representation of each one and its role.<sup>24</sup>

### ***Uncertainties***

The second step is to identify the forces and factors that are both important in influencing future change and unlikely concerning future outcomes or trends. These factors might have a positive or negative outcome. The scenario planning needs to be able to work with both predetermined events and uncertainties to give a whole description. The process should be determined on finding the forces that outline groups of other similar forces or with certain dependence.<sup>25</sup>

### ***Scenario framework***

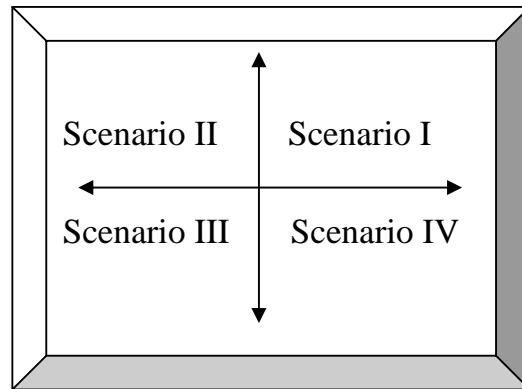
This part describes how to represent the dimensions in combination of uncertainties. The most critical uncertainties will be the driving forces and these represent the central part of the scenario framework. In the scenario structure the directions of the driving forces will differentiate the scenarios from each other. The number of scenarios is considered exhaustive. As stated by Ringland, “*four scenarios encourage divergent thinking and are useful for creating vision; three scenarios lead to the expectation that one is the forecast; two scenarios allow two very distinct (not necessarily low or bad vs. high or*

<sup>24</sup> Ringland, G. (2002)

<sup>25</sup> Ibid

good) scenarios to be developed.”<sup>26</sup> We have chosen to illustrate the future negotiations development scenario in the form of a matrix, as shown in the Figure 2.4.

**Figure 2.4: Scenario Matrix**



Source: Ringland, G. (2002) modified.

### **Characteristics**

The last step is to identify some characteristics for each of the scenarios. It is in order to understand the scenarios and the differences between each other. Once uncertainties and the framework of the scenario are defined, it is needed to go back to the list of driving forces and key factors identified in order to correlate them. It will be the base for the emerging scenarios as well as their implications. The scenarios can be rationalised with a broad or narrow area but the leading characteristics are embedded within the deeper descriptions created with a more reasonable illustration. The ongoing dynamics of the broader environment should be added to the picture. The main purpose of the characteristics is to be able to examine and foresee developments and consequences.<sup>27</sup>

<sup>26</sup> Ringland, G. (2002)

<sup>27</sup> Ringland, G. (2002), Edlund, L., Svenson, K., (2001)

### 3. THEORETICAL FRAMEWORK

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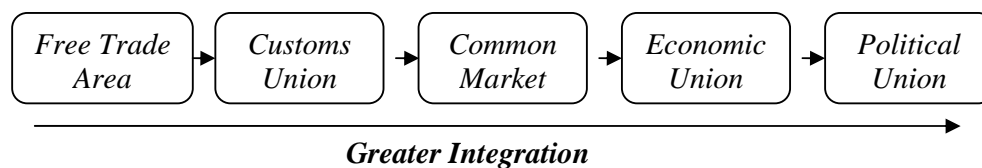
*In this chapter we identify the theoretical framework to be used in the thesis. We begin with the economic integration theory in order to describe the different levels of integration within the trade agreements. Multilateralism, regionalism and bilateralism are other concepts highlighted in this chapter. Further, the measures used by countries to regulate their international trade including policies towards imports and exports and barriers to trade are presented. Finally, a model created by the authors, which shows the interlinking between the principal actors involved in the process, concludes the chapter.*

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#### 3.1 Economic integration

The globalisation and liberalisation processes have been driving the integration of the global economy. The integration implies that the countries in a geographic region co-operate with each other to reduce or eliminate barriers to the international flow of products, people, etc. In this thesis we will use this theory in order to identify the Brazilian international agreements in force as well as their functioning well. When it comes to the future negotiations, some of them involve either bilateral or multilateral agreements. However, the theory will help to identify the potential and principal characteristics of the integration under discussion. *Figure 3.1* shows the different levels of integration.

***Figure 3.1: Levels of Regional Integration***



*Source: Wild, J., et al, 2003, modified*

A *Free Trade Area* is defined as a level of integration in which all members of the agreement remove tariffs and non-tariff restrictions on each other's products without establishing trade policies in relation to third countries. Even in this lowest level of integration, the economic integration implies market

enlargement and influence in economic allocation of resources between members.<sup>28</sup>

The second level of economic integration is a *Customs Union*. The distinguishing feature of this union is that in addition to trade barriers removal, a Common External Tariff (CET) is adopted between the member countries against non-member countries. In the case of Mercosur, for example, if the CET on one product is  $x$ , any imports of that product are levied the same tax to enter the customs union, whether the importer is Argentina, Brazil, Paraguay or Uruguay. When the member states commit to this stage of economic integration, they cannot maintain preferential agreements with third countries and, as a consequence, the group usually acts as a body in negotiation with non-members.<sup>29</sup>

*Common Market* includes in addition to the two previous phases a free circulation of labour and capital amongst members. In this stage the level of economic integration progress is visible and it requires co-operation in economic and labour policy.<sup>30</sup>

*Economic Union* is seen in a higher level of economic integration. It includes all characteristics of a free trade area, of a customs union and of a common market, and also implies unification of economic institutions and co-ordination of economic policy amongst all member countries. However, the political entities are subject to supranational institutions whose decisions are necessary applied to all members.<sup>31</sup>

The most advanced form of economic integration is a *Political Union*. The need to co-ordinate or to adopt economic and political systems between members becomes stronger with the evolution of economic integration. At this point, the union requires member nations to recognise a common position on economic and political policies regarding non-member nations.<sup>32</sup>

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<sup>28</sup> Wild, John J. et al (2003)

<sup>29</sup> Mercado, S. et al. (2001), Dicken P. (2001)

<sup>30</sup> Wild, John J. et al (2003)

<sup>31</sup> Ibid

<sup>32</sup> Mercado, S. et al. (2001), Wild, John J. et al (2003)

### 3.2 Multilateralism

The multilateralism is explained as “international governance of the ‘many’”, and the central principle was the “*opposition of bilateral and discriminatory arrangements that were believed to enhance the leverage of the powerful over the weak and to increase international conflict.*” Multilateralism is also seen as non-discrimination principle. It is the cornerstone of the post-war General Agreement on Tariffs and Trade (GATT) trading system, now the WTO trading system. In addition, it is the principle that has guided member governments through eight rounds of multilateral trade negotiations. These negotiating efforts have reduced developed country tariffs on industrial goods from more than 40 percent to less than 5 percent. As a result, the negotiators have gradually more addressed non-tariff barriers to trade. The Uruguay Round was an intensive effort to update the multilateral trading system, and make it more effective as a negotiator of economic relations among nations, since the relations have become more intense, more complex and more wide-ranging than ever before. For example, some countries have preferred assent in more effective processes as bilateral agreements make the original purpose of the multilateralism of free international trade more difficult.<sup>33</sup>

If this context of multilateral co-operation is to be successful, its different actors need to understand that they are working towards a better future benefit that will require certain drawbacks to different extents, by different actors. The multilateralism explains that developed and developing nations will have different roles to play in co-operative efforts, given their different needs and potential, and based upon these differences, the benefits of co-operation will seem more immediate to some actors than to others. Some of the critics of multilateralism argue that it interferes with market operation, characterised by bureaucratic enforcement, and it does not succeed in accommodating the different preferences and capabilities.<sup>34</sup> The importance of the base or support from the WTO will impact its main focus, which is multilateral trade liberalisation. For Brazil taking part of a number of commitments under the WTO, it will constitute a fundamental framework to take part in the international economy.

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<sup>33</sup> Yale Center for Environmental Law and Policy and Dicken P. (2001)

<sup>34</sup> Dicken P. (2001)

### 3.2.1 Brazil in the WTO

The Uruguay round held under the GATT resulted in the creation of the WTO and Brazil became a member of in January 1995. Since then Brazil has participated in sixteen different disputes as a complainant and as a defendant, it was also involved as a third party in four disputes. This helped Brazil to build knowledge about opportunities and limitations embodied in the rules of the WTO; it brought the experience of being actively involved in the creation of worldwide trade regime. Participation in the WTO negotiations enhances Brazil's bargaining power, increases negotiating skills and makes the country ready for entering "post-globalisation" stage.<sup>35</sup>

Being a country big in size with great potential and enormous natural resource base and having a diversified economy, Brazil has always been interested in establishing a multilateral trade system to be able to have access to other markets. Conversely, Brazil's partners at the WTO pursued opening of Brazilian market and liberalisation of its trade policy. The main objective of Brazil within the WTO is to implement all negotiated trade agreements and to deepen integration processes, to develop trade and to improve conditions for a better market access and opening for free trade, thus to further eliminate barriers to trade.<sup>36</sup> But it is important to note that the role of Brazil will increase in the WTO and its dispute settlement mechanism, influencing rule-making, if it commits to multilateral disciplines to a greater extent.<sup>37</sup>

Brazil, as other developing countries, has been granted a transition period in order to be able to put into action a number of commitments under various WTO agreements and those agreements constitute a fundamental framework for Brazil to play a part in the international economy.<sup>38</sup>

### 3.3 Regionalism

The regionalism is defined as "*actions by governments to liberalise or facilitate trade on a regional basis, sometimes through free-trade areas or customs unions*".<sup>39</sup> In another context, the regional trade agreements (RTAs) have both a general and a specific meaning. In the general meaning, the RTAs may be complete agreements between countries not necessarily taking place in

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<sup>35</sup> INTAL (2003)

<sup>36</sup> WTO

<sup>37</sup> Pontifical Catholic University

<sup>38</sup> WTO

<sup>39</sup> Ibid



the same geographical region. In the specific meaning, the WTO provisions relate to the conditions of preferential trade liberalisation with RTAs. The coverage and depth of preferential treatment varies from one regional trade agreement to another. Some of the new RTAs are not necessarily linked to the most developed economies; these gradually provide regulations governing intra-trade (e.g. standards, safeguard provisions, customs administration, etc.) and also provide a preferential regulatory framework for mutual services trade. When it comes to the most sophisticated RTAs, these go further than traditional trade policy mechanisms, to include regional rules on investment, competition, environment and labour. The EU, NAFTA, the Association of Southeast Asian Nations, the South Asian Association for Regional Cooperation, and Mercosur, are examples of RTAs. In July 2003, only three WTO members- Macau China, Mongolia and Chinese Taipei- were not participant to a regional trade agreement. As a matter of fact, in May 2003, there were 265 RTAs notified to the WTO (and its predecessor GATT). It is expected at the end of 2005 that the total number of RTAs in force might approach 300.<sup>40</sup>

These days the regionalism is being viewed as a solution to the major international economic problems. As a result of the slow progress of the negotiations at the Uruguay Round of the GATT, some economists have concluded that a division of the world into three trading blocs, for example, Europe, the Americas, and East Asia, has led to a path of multilateral free trade. Also, for many countries the increase of non-tariff barriers in the world trade has made regional integration an attractive policy option. The regionalism framework is seen almost from five decades ago by the creation of the European Community in 1958. The United States, previously opposed to regionalism, noticed a united Western Europe and followed the pattern with creation of NAFTA. This was rapidly followed by a creation of regional arrangements around the world, especially in the developing countries of Africa and Latin America. The primary motive behind the movement in the developing world was industrialisation through regional import substitution. The new industries thought that they could first learn to export without protection for the regional market and then face world competition. As a consequence, the import substitution failed in the regions. Then, by 1970s export-oriented policies had begun to take note of the policymakers and later

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<sup>40</sup> WTO

on, the unilateral and non-discriminatory trade liberalisation started to increase as well as the regionalism.<sup>41</sup>

The impact of regionalism on global trade has been controversial and some authors have concluded that new regional arrangements will act as “building blocs” for an integrated global system. The contribution of the new regionalism in global trade will depend on whether the regional integration is followed by rise or fall of protection in these regions. The latter will depend on the strength of multilateral trading discipline, for example, the WTO. There exists the possibility that new regionalism will be competing with globalism unless multilateral trading discipline is intensified and it points out an important direction in the emergence of regionalism aspect. Regionalism needs a well-functioning multilateral trading system in order to complement globalism.<sup>42</sup>

### ***Regionalism and the WTO***

The increase of the RTAs and their expansive scope led to a new debate on the effect of regionalism on multilateral trade negotiations. The question arises what role the WTO should play in moderating RTAs. As a matter of fact, all RTAs fall under the WTO's jurisdiction and it mandates that each member accords Most Favoured Nation (MFN) status to all other members. The RTAs could be seen as incompatible with MFN status by allowing members to extend different terms of trade to nations not participating in the agreement. Even though, the WTO allows regional trade initiatives as a regulated exception. There are two principal conditions: the agreement must lower trade barriers within the regional group and the agreement cannot increase trade barriers for non-participating members. There exists a Committee on Regional Trade Agreements in order to examine the rules in the agreements.<sup>43</sup>

The principal attention between regionalism and the WTO is the effect that RTAs have on multilateral trade negotiations and whether or not the WTO should support them. On the positive side, the regional initiatives allow countries to liberalise by gradually increasing the level of competition and allowing domestic industries time to adjust. In this case, also the political pressures and regional diplomacy can resolve issues concerning multilateral negotiations. When it comes to the negative effects, the RTAs are described as

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<sup>41</sup> Jovanovic, M.N. (1998) and Schirm, S.A. (2002)

<sup>42</sup> Jovanovic, M.N. (1998)

<sup>43</sup> WTO

competing trade interests that delay any multilateral agreement. Besides, the preference systems could create political and economic tensions as well as they complicate the WTO efforts to unify disagreements procedures, therefore impeding global trade talks.<sup>44</sup>

The agriculture, steel, automobile, and textile sectors have obstacles in almost all of the RTA negotiations. These are politically sensitive sectors that might create dispute in the settlement of the negotiations. Also, there are countries at the same time negotiating over three agreements and participating in the Doha rounds (January 2005), they have difficulty standardising agreements and maintaining links with the multilateral discussions. Another worry is that the volume of RTA activity has tensed negotiation capacities in the case of developing countries. All of these factors affect both the success of RTAs and their impact on the WTO's main focus, which is multilateral trade liberalisation.<sup>45</sup>

When it comes to the regional integration of Brazil, the agreements of LAIA, Mercosur and future negotiations of FTAA are examples of regionalism. These agreements are presented in the next *Section* and these are the only ones that represent the regionalism of Brazil at the moment.

### **3.3.1 Regional integration of Brazil**

#### **3.3.1.1 LAIA – ALADI**

Brazil is a member of the Latin American Integration Area (LAIA) or the Spanish name Asociación Latinoamericana de Integración (ALADI) which is an organisation that was established by the Treaty of Montevideo (August 1980) and which came into force in March 1981 and was fully ratified in March 1982. It seeks economic co-operation among its 12 members: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Cuba and Venezuela.

The LAIA organisation substituted the Latin American Free Trade Association (LAFTA- Asociación Latinoamericana de Libre Comercio), which had been established in 1960.<sup>46</sup> The principal purpose of this former organisation was the

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<sup>44</sup> WTO

<sup>45</sup> Harvard University (2003)

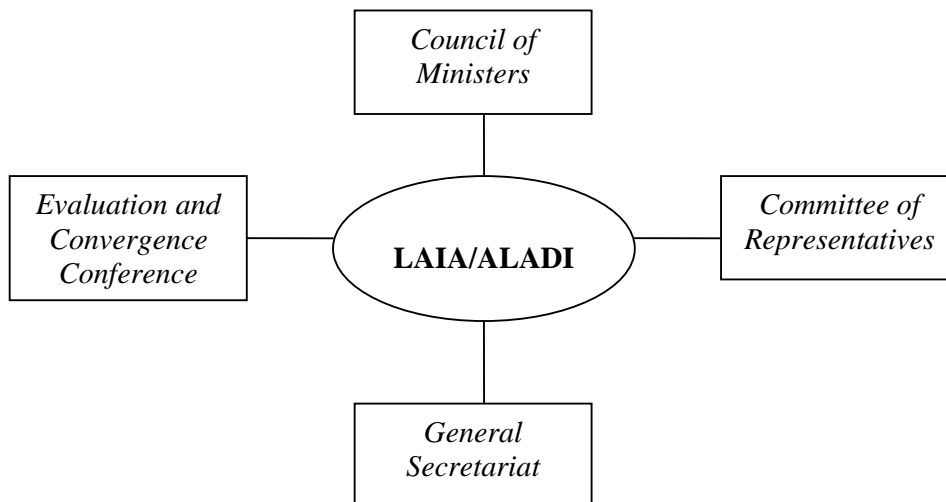
<sup>46</sup> Nation Master

development of a common market in Latin America. There were certain complications with this scheme; therefore, LAIA was created with a more flexible and more limited role of encouraging free trade but with no timetable for the institution of a common market.<sup>47</sup>

The union of macroeconomic policies combined with the process of opening of markets and the need to expand exports began to stimulate new integration agreements in the region. The integration within this trade agreement was no longer observed as an expansion of protected markets against third countries; it was instead seen as part of the process of slowly opening up to international trade.

The LAIA trade agreement comprises a range of agreements, for example, Mercosur comprising Argentina, Brazil, Paraguay and Uruguay, the Andean Group comprising Colombia, Venezuela, Ecuador, Bolivia and Peru, the recently approved Group of Three (G3) Venezuela, Colombia and Mexico and other bilateral and sector agreements intended to open up markets for the relatively less developed countries.<sup>48</sup> In the following *Figure 3.2*, the structure of LAIA/ALADI is described.

**Figure 3.2: Structure of LAIA/ALADI**



Source: *Governmental & Institutional Affairs- Volvo do Brasil, 2003*

<sup>47</sup> Europa World Year Book and Volvo do Brasil (2003)

<sup>48</sup> International Labour Organisation (2003)

### 3.3.1.2 Mercosur

Brazil's most advanced regional integration is Mercosur (the Southern Cone Common Market), also known as Mercosul (in Portuguese), which was established in March 1991. The member states are: Argentina, Brazil, Paraguay and Uruguay with the approval in the Treaty of Asunción.

The Mercosur primary objective is to achieve the economic integration of member states with a free flow of goods and services between them, the establishment of a common external tariff, the implementation of common commercial policy, and the co-ordination of macroeconomic policies between others. Despite this integration, that has made some remarkable progress, there are some disputes and conflicts between member countries. As a customs union several conflicts of interest and disagreements remain. When it comes to the common market, it has a need of a great deal of effort and commitment, especially concerning the services and labour aspects as well as the co-ordination of macroeconomic, industries' and legislative policies.<sup>49</sup>

#### ***Consolidation for Custom Union and launching of Common Market***

Mercosur is a political project with a very strong link with a social dimension. This is the Mercosur identity. The principal objective of the government within these member countries has been the interest to progress in Mercosur markets and other South American countries because the cargo, logistics, roads, etc. are similar. Nevertheless, there are some gaps to achieving a common market or consolidating the customs union. In order to improve, it is necessary to work with the asymmetric principles, which imply the disparities of economic development of member countries. As a result, the Mercosur social and economic factors move faster than the customs union due mainly to the macroeconomic issues, for example, the economic instability amongst these countries. The different crises and their vulnerable economies have affected this regional bloc, as consequence the countries independently build-up some resistance in this process. The principal complainants or resistant actors are Uruguay and Paraguay. This is always related to the principal threats to their small industries or even more to their economies. Moreover, the big challenge of this trade agreement has to deal with the convergence system and regionalism as a process to achieve the system as a whole.<sup>50</sup>

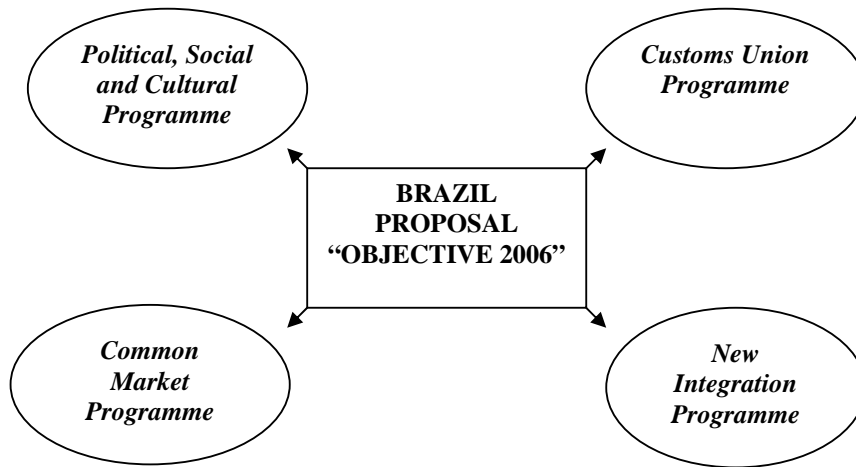
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<sup>49</sup> Interview in Ministry of Foreign Affairs, Mercosur Division

<sup>50</sup> Ibid

A plan of convergence has been developed by Mercosur members in order to create and consolidate the bloc. In *Figure 3.3* an abstract of this future plan “Objectives – 2006” is illustrated.

**Figure 3.3: Principal factors involved in the “Objective 2006” agenda.**



*Source: Authors' elaboration*

The most important points within the *Political, Social and Cultural Programmes* are expected to cover the participation in the civil society through Social and Economic Forum of Mercosur which has representatives from consumers, syndicates, and business. In addition, to build-up a collaboration of Mercosur Commission and National Congress, a national section of the Parliament was created in order to improve negotiations and to increase interaction with the decision-making organisations of Mercosur. The Mercosur citizenship is another significant point that has been discussed, for example, migration agreements, legal processes and judicial co-operation between the member countries.<sup>51</sup>

In the *Customs Union Programme*, the asymmetric treatment is expected to be involved, in order to reach competitive and better integration levels. Also, the CET has to be completed by 2006. It will have certain amount of exceptions but these have to be defined by year 2004 in order to simplify and harmonise

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<sup>51</sup> Interview in Ministry of Foreign Affairs, Mercosur Division

the intra-zone customs procedures. In addition, there will be a common special regime which will allow importing without the tariff payment. The Free Trade Zones (FTZs) have to establish conditions for the fulfilment of Mercosur requirements. In this programme the positions of the common external negotiations, common commercial defence (elimination of antidumping measures, etc.) are described, as well as productive integration, financing instruments, incentives programme, institutional reinforcement, macroeconomic co-ordination among others.<sup>52</sup>

In the *Common Market Programme* the ratification of the services liberalisation as well as the establishment of multi-sectoral commitments are expected. Like the European Union, there will be the support for the regional capital market and regional investment promotion. Moreover, there are some discussions about the pre-requirements to establish a common currency between Mercosur members. Finally, the *New Integration Programme* involves 22 new projects; these are agreements regarding the education within Mercosur, science and technology programmes, advanced productive integration and physical integration. The emphasis seen within this “Objective 2006” would be the importance of co-operation between the Mercosur members in order to get positive outcomes.<sup>53</sup> Mercosur will be discussed further on or in *Section 4.5.2*.

#### *3.3.1.3 Free Trade Area of Americas (FTAA)*

In 1994, the Free Trade Area of the Americas (FTAA) comprising 34 countries’ heads of state from Latin American, Canada, United States and Caribbean countries (except Cuba) was negotiated. This first “Summit of the Americas” included a goal of increased prosperity from trade liberalisation and greater integration of these regional economies. The creation of this regional bloc is planned by the year 2005.<sup>54</sup> There are many discussions regarding formation of the bloc, its benefits and drawbacks, as well as problems arising in the negotiations. As this regional integration agreement is in the process of negotiations, the main points of it will be discussed in *Section 4.6* of future negotiations.

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<sup>52</sup> Interview in Ministry of Foreign Affairs, Mercosur Division

<sup>53</sup> Ibid

<sup>54</sup> Inter-American Development Bank and Trade Observatory (2003)

### 3.4 Bilateralism

In recent years, there has been immense research on the relative merits of bilateralism and their implications for the nature of the trading regime between countries. Bilateralism refers to co-operative interaction and thus describes a policy or strategy that proceeds through bilateral ties. Within the principal characteristics of bilateralism we can find that these are instruments for pursuing global trade and investment. Also, the bilateralism offers preferential treatment and promotes progressive liberalisation. There are three direct effects when a pair of countries signs a trade agreement which lowers import tariffs. For example, the domestic firm faces greater competition from a foreign firm; also, the domestic firm gets greater access to the foreign market and the domestic consumers benefit from greater competition, in terms of lower prices. In addition, there is an interesting indirect effect of such bilateral agreements; these make the markets of the countries signing the agreement less valuable to other active firms in the market. The countries adopt bilateralism to the extent that there are interests better advanced by maintaining separate relationships with other actors. The possibility of selling in foreign markets depends on the nature of import tariffs faced by firms, therefore, countries can sign bilateral free trade agreements which lower import tariffs and thereby facilitate trade. The principal fact is that bilateralism is consistent with global free trade and its expansion.<sup>55</sup>

### 3.5 Trade barriers: tariff, non-tariff

National governments establish trade policy of the country in order to apply it as an instrument protecting, stimulating or controlling economic activity, investment and trade flows. As a general rule, governmental policies are directed to promote exports and to restrict imports. There are different reasons stand behind this. Firstly, the government uses trade policy in order to improve trade balance. In this case, the policy has the most restrictive nature towards imports, if there is a trade deficit experienced by the country. Secondly, the reason can be to protect local industries especially if they are at infant stage.<sup>56</sup> Government policy can also be driven by the political motives including *“protection of jobs, preserving national security, responding to unfair trade*

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<sup>55</sup> Van Brabant, J. M. P. (1973)

<sup>56</sup> Dicken P. (2001)



and gaining influence over other nations”.<sup>57</sup> There are two categories that can be used by the government to restrict trade: tariffs and non-tariff barriers.

### 3.5.1 Tariffs

Taxes imposed on the value of imported products, which increase price of imports and reduce competitiveness of the goods, are called *tariffs*.<sup>58</sup> As a rule, tariffs levied on the raw materials are lower than those levied on finished goods, allowing importation of materials and inputs for the production process in the country and restricting importation of manufactured products to protect domestic producers from stronger competition. It is important to mention that there is a trend of tariff reduction in the world economy as the rounds of international negotiation in GATT were successfully accomplished motivating growth of international trade.<sup>59</sup>

Wild et al. classify tariffs in three major categories, which are *export tariffs* imposed by the government on exported goods and usually used when the price is considered lower internationally; *transit tariffs* levied on the goods crossing the country to final destination, which are almost eliminated nowadays; and *import tariffs* levied on imported goods to the country. Further, the import tariffs can be classified depending on the method of their calculation. A *specific tariff* is a permanent fee for each imported unit. Another import tariff is called *ad valorem tariff*, which is imposed as a percentage of the total value of imported goods. Finally, a *compound tariff* is calculated partly as a percentage of the total value of imported goods plus partly as a fixed fee for each unit, combining both tariffs mentioned above.<sup>60</sup>

### 3.5.2 Non-tariff barriers

It should be stressed that today non-tariff barriers are more important than tariffs since they became to be a popular instrument for trade restriction. One important factor to mention is that sometimes these barriers can be hidden in the general economic and financial policies of the country and are difficult to identify. *Non-tariff barriers*, which limit the quantity of imported goods, can take various forms.<sup>61</sup>

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<sup>57</sup> Wild, John J. et al (2003)

<sup>58</sup> Dicken P. (2001)

<sup>59</sup> Ibid

<sup>60</sup> Wild, John J. et al (2003)

<sup>61</sup> Asheghian, P. (1995)

**Quota**, a widely used non-tariff barrier, is a limitation of the amount of goods that can cross a country's borders.<sup>62</sup> The imposition of quota on the imported commodities is called *import quota*, the purpose of which is usually to protect domestic producers in order to restrain competition on the domestic market. The consequence of this trade barrier is normally reflected in the consumers' loss because of higher prices and limited selection of goods as well as in the companies that employ the imported materials in the production process, increasing their costs. An import quota can be *unilateral*, levied by the country without negotiations with exporting country, and *bilateral* or *multilateral*, when it is imposed after negotiations and agreement with exporting country. An *export quota* is a restricted amount of goods that can leave the country. There are different reasons for imposing of export quota by the country, which can be the guarantee of the supply of the products that are in shortage in the domestic market, manipulation of the prices on the international level, and the control of goods strategically important for the country.<sup>63</sup> In some cases, the importing countries request exporting countries to impose *voluntary export restraints*. It is an export quota “*at the request of other countries in response to the threat of an import quota or total ban on the goods by an importing country.*”<sup>64</sup>

There is also a combined form of trade barrier called *tariff-quota*. It represents a certain tariff rate (or zero tariffs) for a limited amount of imports and a higher tariff rate for the amount of goods that go beyond quota. This kind of trade restriction is commonly used by the developing countries or by economies in transition; and very often in the agricultural sector.<sup>65</sup>

Another non-tariff barrier is ***local content requirements*** forcing the domestic producers to procure a certain amount of inputs employed in their operations locally. It is obligatory for the company to have a certain portion of the final product comprised of domestically produced goods. The government introduces this law mainly to stimulate the industrial development in the country; it sometimes can pursue the aim of supporting local suppliers.<sup>66</sup>

***Subsidies*** are considered as an indirect form of trade barriers, which can be granted to exporting companies to be able to cover costs, lower the price of

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<sup>62</sup> Asheghian, P. (1995)

<sup>63</sup> Ibid

<sup>64</sup> Wild, John J. et al (2003)

<sup>65</sup> Ibid

<sup>66</sup> Ibid

exports, and to allow them to compete internationally. Subsidies are provided for the domestic companies also to make their products more competitive against imported goods. The drawback of subsidies is that they make “*less efficient producers compete more successfully with more efficient producers*” on the international markets.<sup>67</sup> In response to this policy, an importing country can impose countervailing duty in case it believes that the goods were unfairly subsidised by the home government. The WTO strongly controls the government policy regarding subsidies in order to support fair competition and free trade.<sup>68</sup>

***Administrative and technical regulations*** also create obstacles for free trade, though most of the time they do not intend to restrict trade. These include health and safety standards, labelling and packaging standards, customs procedures and valuation. However, bureaucratic rules of customs procedures prevent a rapid flow of goods.<sup>69</sup>

There are many other forms of non-tariff barriers applied by the government such as ***intervention in foreign exchange markets***, manipulating currency exchange rate and making the imports more expensive; the establishment of ***embargos***, completely prohibiting importation of goods. The latter is the most restrictive tool, which is applied mostly due to political goals. ***Dumping*** is the practice, “*when a company exports goods at a lower price than the production costs or the price on the domestic market*”.<sup>70</sup> In this case, an importing country can impose anti-dumping duty in order to increase price and compensate the impact of dumping. *Table 3.1* below gives a list of the main trade policies that can be applied towards imports and exports.

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<sup>67</sup> Asheghian, P. (1995)

<sup>68</sup> Ibid

<sup>69</sup> Ibid

<sup>70</sup> Wild, John J. et al (2003)

**Table 3.1: Major types of trade policies pursued by government towards exports and imports**

<i><b>Policies towards imports</b></i>	<i><b>Policies towards exports</b></i>
<i>Tariffs</i>	➤ Financial and fiscal incentives
<i>Non-tariff barriers</i>	➤ Export credits and guarantees
➤ Quotas	➤ Establishment of overseas export promotion agencies
➤ Import license	➤ Establishment of Free Trade Zones
➤ Import deposit schemes	➤ “Voluntary export restraint”
➤ Import surcharges	➤ Embargo on strategic exports
➤ Anti-dumping measures	➤ Exchange rate manipulation
➤ Labelling and packaging requirements	
➤ Health and safety regulations	
➤ Customs bureaucracy	
➤ Subsidies to domestic producers	
➤ Countervailing duties on subsidised imports	
➤ Local content requirements	
➤ Exchange rate manipulation	

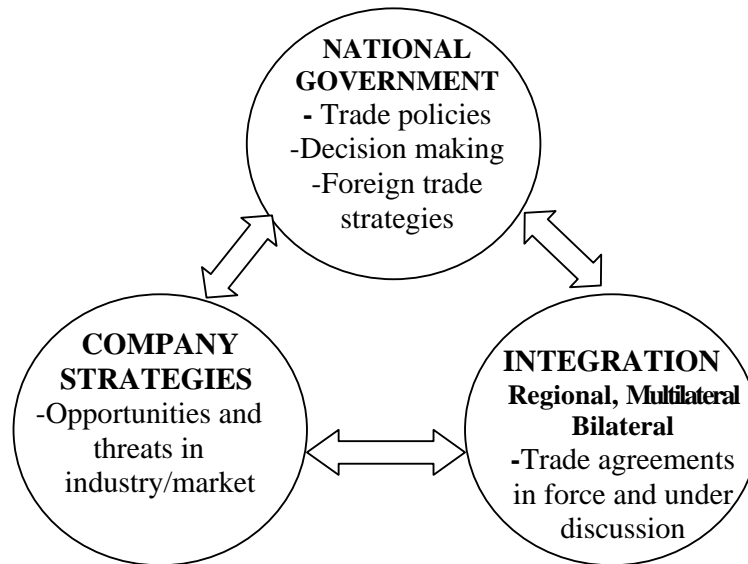
Source: Dicken, P., 2001

### 3.6 Structural relationships of the principal actors

In our case we have identified the most important issues to investigate in order to answer the main problem, and the most important actors to study in order to arrive at the conclusions. The following model was created in order to link the relationships of the principal actors; it will explain how the interdependencies of these three actors elaborate and co-ordinate in order to fulfil independent opportunities. In addition, these relationships will bring the opportunity to identify the important consequences for the Brazilian HDV industry. The model will help to analyse how the company develops and modifies its strategy according to the current and future government policy, trends in the changing pattern of trade and economic integration of the countries. It will also help us examine how the company, representing particular industry and through the associations of the industry, can influence the government policy, and what prospects it will obtain from the international markets opening as a result of economic integration. The following *Figure 3.4* presents the adaptation of rules

imposed by national and supranational levels, and the relationships amongst the principal players are shown.

**Figure 3.4: Structural relationship of the principal actors**



*Source: Authors' elaboration*

### ***National Government, Integration and Company's strategy Interdependence***

The first interdependency involves company's strategy and government. From the company's prospective, in order to develop its business successfully, it has to adjust its business performance and operations according to the rules and regulations established by the government of the country. The different structures of policy-making in the country might assist or affect the specific international interests of companies. In some countries, the government policy takes a very restrictive nature towards international trade as well as internal industrial and economic development, while others are more liberal and open. The government's tools used to influence, for example, tariffs and taxes, subsidies, technical regulations and other requirements, financial schemes, etc., might help or undermine the company's opportunities in particular industry or market. It is crucial for the company to monitor, estimate and predict the future government policy to facilitate its strategy development and implementation. But at the same time, the companies can put some pressure on the government in order to fulfil their specific objectives, arising from the need to grow, to sustain competitiveness or to see new ways to gain scale advantages, to seek new resources, to expand their operations, etc. As an example, the companies

can force the government to protect the industry from new entrants or to bring opportunities on the new markets through negotiations of trade agreements with other countries.

The function of the government influences how trade policies and structure affect the decision to undertake certain specific trade negotiation as well as the company's strategies in the country. The relations between government and commercial integration can be explained by the following interdependencies. On the one hand, the government through negotiations with other countries contribute or prevent deepening or widening of the integration. It is the government that participates in the negotiations and makes the final decision on what countries should be considered and negotiated with, to what extent the unification should be, and what areas the agreement should cover. On the other hand, economic integration process under the WTO regulation forces the government to change its trade policy and negotiate certain conditions of the agreement.

Finally, we come to relations between economic integration and the company's strategy. The regional economic integration alters the scope of the company's marketplace, offering new opportunities and opening new markets for goods and services. Also, trade agreements can be a driving force for companies' strategy to improve efficiency and productivity due to the increased competition on the open markets. It can be said that regional integration can significantly change the strategy of a company. The companies' influence on regional integration is more indirect and is implemented through the government. Seeing potential markets or access for materials and inputs, for example, companies in close co-operation with the government develop and promote beneficial prospective negotiations. Furthermore, some of the trade agreements in force probably could not benefit or succeed as planned, therefore both government and companies should work on the strengthening the integration.

## 4. EMPIRICAL STUDY

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*In this chapter, the findings of our investigation are presented. We begin with the short overview of Brazil followed by a description of our case company Volvo do Brasil and its strategy. The chapter then provides the general picture of the main trends and performance of automotive (HDV) industry in Brazil. In this part of the thesis, Research Question I and Research Question II are presented, dealing with the issues of trade policy in Brazil and trade barriers an automobile manufacturer faces. The international trade agreements of Brazil, which involve automotive industry, are also covered. Furthermore, an extensive description of on-going negotiations of future trade agreements between Brazil and other countries is given.*

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### 4.1 Overview of Brazil

#### *General information*

Brazil is the largest country in Latin America and the fifth country in the world occupying half of the territory in the South American continent. It has boundaries with nearly all countries in South America excluding Ecuador and Chile. Brazil is considered to be a good natural resource-based country with one of the richest natural environments.<sup>71</sup> The population of Brazil reached over 170 million in 2002 making it the fifth most populated country in the world though the population growth is decreasing. The distribution of income is very uneven and varies greatly according to the state. Roughly 20% of the population live below poverty level.<sup>72</sup>



Brazil is a federative republic (*Republica Federativa do Brasil*) and consists of 26 states and one Federal District, which have their own government. The Constitution defines power for the Executive, the head of which is the President, elected for a four-year period, who appoints The Cabinet of

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<sup>71</sup> Brazilian Embassy in Washington

<sup>72</sup> CIA

Ministers. The election of the new President, Luiz Inácio (Lula) da Silva, the representative of Worker's Party, took place in October 2002.<sup>73</sup>

### *Economy*

Brazil is the tenth largest economy in the world and the main player in South America. Economic growth has experienced fluctuation during recent years and the main reason for it was the financial crisis in 1998 followed by devaluation of Real (*reais*), the national currency, by 30% against US dollar in January 1999. Financial crisis and inflation slowed down economic development of the country, however, it performed better than expected and a slight recovery was noticed already in the year 2000. The government has implemented significant reforms to increase economic stability of the country and introduced a strategy to reduce macroeconomic imbalances, allowing the currency to float, accelerating public sector adjustments, implementing fiscal adjustment programme approved by the International Monetary Fund (IMF) and further deepening structural reforms. The Gross Domestic Product (GDP) composition by sector shows that agriculture accounts for approximately 8% of national production, 34% stands for industry and services accounted for 58% in 2001.<sup>74</sup> Brazil is considered as a key emerging market with a big potential, but also considerably risky because of dependence on the world economy and its big debt burden. The main economic indicators of Brazil are presented in *Appendix I*.

### *Foreign Direct Investments and Trade*

Foreign direct investments (FDI) in Brazil have increased significantly since 1996, reaching the maximum figure of more than US\$30 billion in 2000, though in the last two years FDI inflows dropped and remained at the lower level. Despite the decline, Brazil still remains the largest FDI recipient in the Latin America, accumulating 34% of all investments into the region. The concentration of investments was mainly in the automotive, metallurgical sectors, the electric and electronic industry, and chemical industry. The FDI flows have been encouraged by favourable government policy, privatisation and attractiveness of a large internal market, including opening of Mercosur markets.<sup>75</sup>

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<sup>73</sup> CIA

<sup>74</sup> World Market Analysis

<sup>75</sup> SICE (II)



Brazilian foreign trade has grown since creation of Mercosur and trade policy has been liberalised recently stimulating trade flows across borders, however, trade barriers still remain high. The major export and import markets of Brazil will be described in *Section 4.4*. Brazil is a major exporter of agricultural products, and an importer of mostly manufactured goods. A trade deficit of US\$697 million was recorded in 2000 and the government policy was directed towards reduction of considerable trade deficit, stimulating export and reducing export costs, and by the year 2002 there was a surplus of US\$13.1 billion.<sup>76</sup>

#### *International relations*

Brazil is an active player in the multilateral and numerous bilateral systems promoting and regulating stabilisation, trade opening, economic development, national security and establishing international relations with other countries. As mentioned before, Brazil is a member of the LAIA, Mercosur, WTO and other world organisations.<sup>77</sup>

## **4.2 Case company - Volvo do Brasil**

### **4.2.1 General description**

The Volvo business in Brazil started in 1934 through a sales subsidiary and VdB, a truck and buses plant located in Curitiba (the southern state of Paraná) was established in 1979 through green-field investments. It supplies buses and trucks to the South American market. This plant is the third cabin plant and second engine plant worldwide. VdB is defined as a “main factory”, responsible for the production of complete vehicles, including chassis, engines, transmissions and truck-cabins reinforced by design and engineering departments, however, the major models are produced on the basis of global design and development in Sweden. Also, VdB has its own supplier system, whereby domestic actors have a considerable share of parts and components for the assembled vehicles. All the units are gathered together at the same facility, for example, the global production, driveline, vehicle plant and sales (buses, trucks, etc.) enable it to make quick decisions.<sup>78</sup>

The plant has around 1 600 employees with a production capacity of 12 000 trucks, 22 300 engines, 11 500 cabins and 2 400 buses a year. In 2002, VdB

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<sup>76</sup> European Union On-line

<sup>77</sup> Ibid

<sup>78</sup> Volvo do Brasil (2003), Ivarson, I, Alvstam, G., (2003)

produced 4 823 trucks and 729 buses compared with 4 605 and 1 249 in 2001, respectively. The same year, 4 318 trucks were sold on the domestic market and 531 abroad, hence reaching a 31% share of the Brazilian heavy truck sector. In the first half of year 2003, VdB became the leader in the heavy truck segment. The sales increased by 2.6% in volume terms, while a 6.2% decrease was observed on the domestic market.<sup>79</sup>

In the heavy vehicle segment, it completed the new global product programme by launching the Volvo NH in South America. With the launch of the Volvo NH, the company's global product range has now been completely renewed. This marks the total renewal of the entire Volvo truck range in South America. As part of the VTC strategies, earlier in September this year, it broadened the customer offer in Brazil by introducing a new truck in the 17–23 ton class, the Volvo VM and NH. The Volvo VM has been developed to meet the South American customers' demand for a truck for regional distribution and urban operations. The new Volvo VM can be delivered with a fully-built body directly from the factory in Curitiba. The new truck is the first to take advantage of the VG's increased scale, where some components are shared with other truck brands.

This plant is characterised by its organisation in terms of quality and control in products and services. The dealer network includes 109 dealers in South America; it receives continuous training and technical update of mechanics, administrative and sales force. When it comes to the components, there is a distribution centre with around US\$17 million of inventory and 56 thousand items turnover. It distributes to 141 dealers, 57 direct customers, and 10 importers and 4 trading companies, also it serves VTC, VBC, Volvo Construction Equipment and Penta. Most of the decisions are made by VBC and VTC.

In Brazil, there are exports of complete trucks and buses, mainly to markets in South and Central America, but also to Europe. The principal export markets in South America for completely built-up units (CBUs) of trucks are Argentina and Chile. The truck cabins are also exported from Brazil to the plant in Belgium and engines are exported to Sweden. When it comes to the export of CKDs, VdB has principal markets of South America, the EU and the United

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<sup>79</sup> Swedish-Brazilian Chamber of Commerce (2003),

States (US). Regarding the imports of CBUs, although VdB does not import high numbers, these come from Europe and it is principally intra-company trade. The import of CKDs mainly originated from the EU (France, Belgium and Sweden), the US and Argentina (Mercosur member).<sup>80</sup>

VdB is focusing intensively on the customer satisfaction and extended offers concepts. In addition to trucks and buses sales, there are also service agreements, financing and insurance companies, etc. This has been part of its differentiation tool with competitors. The company was the first company to introduce new technology, such as engines with electronic fuel injection, air conditioning, driver's cabins with safety cells and airbags. Also, it opened up the heavy-duty trucks market and helped to improve traffic safety. In relation to this, VdB launched 15 years ago a programme called Volvo's traffic safety programme which supports the concept of traffic safety. When it comes to buses, VdB has a prevailing position with wide-ranging systems for passenger transport, for example, the double-articulated and articulated buses in Curitiba. 80% of the buses in this city consist of Volvo chassis. The principal purpose of these buses is to increase the capacity of passengers and to reduce the pollutants.<sup>81</sup>

VdB had a good performance, with its turnover jumping 24% from R\$1 billion in 2001 to R\$1.24 billion in 2002.<sup>82</sup> This shows how VdB is continuing investing in products and services as well as being a profitable business, thus achieving a higher competitiveness in the region and globally. The export of CKDs and CBUs produced in Brazilian market outside the region also helped to increase revenues.

#### **4.2.2 Volvo do Brasil Strategies**

The future trend of VdB is driven by the Volvo Group general strategies. In this context Volvo is seeking for continuing representation of its well-known brand name image and customer satisfaction as well as the sustainable profitability and growth rate. Volvo has installed production for buses and trucks strategically: one in South America (Brazil), one in Australia, China, etc. and these have been placed in order to be able to supply other markets. This

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<sup>80</sup> Volvo do Brasil (2003), Ivarson, I., Alvstam, G., (2003)

<sup>81</sup> Volvo Library , Volvo Eu Rodo

<sup>82</sup> Volvo Eu Rodo

strategy has been assumed on VdB's operations in order to achieve a specific market, especially South American.<sup>83</sup>

There is an opportunity for VdB to specialise in producing certain models and supply globally. Volvo was considering the concept of specialisation, which allows a global supply from one site, but it is still under discussion.<sup>84</sup> Today, emerging markets, for example, China and India attracted the particular attention of VdB. The size of these markets is appealing and the growing economies indicate the prospects of potential business there. This created the VdB's interest in exploring opportunities in these countries, however, South American market still remain a priority. There is a special interest in forcing the government to integrate with the countries in South America as well as to expand to the emerging markets.<sup>85</sup>

When it comes to the components, some of them are imported; therefore there are some obstacles with this due mainly to the high import taxes, risk of exchange rates, inflation problems, etc. This dependency on import might undermine the competitiveness of VdB when it is compared with its principal competitors Mercedes and Volkswagen (VW) who produce 90% of components in Brazil. Therefore, it is important for the company to reduce costs in order to stay competitive in the domestic and also international market.

On the celebration of its 25<sup>th</sup> year in Brazil, VdB plans to invest US\$100 million in the country over the next three years which is part of the expansion of its product line. VdB launched the production of medium trucks and plans to develop the medium-truck segment.<sup>86</sup>

### **4.3 Automotive industry**

This industry is described to give an introduction to the reader to understand the development stage of the industry VdB operates in. It is fundamental to have a picture of the automotive (HDV) industry development in Brazil, who the main players are, what problems and perspectives it has and what trends are observed.

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<sup>83</sup> Interview in VdB

<sup>84</sup> Ibid

<sup>85</sup> Ibid

<sup>86</sup> Volvo Eu Rodo

### **4.3.1 Global trends**

Increasing competition and globalisation are the most important trends in the automotive industry nowadays. The results of globalisation processes are mirrored in the product and quality development, as well as in reduction of production costs, increased rationality and efficiency. There is a large number of joint ventures, takeovers and co-operation agreements in order to sustain costs.<sup>87</sup>

The geographic pattern of demand has also changed and the importance of emerging markets such as Asia, Eastern Europe, and Latin America is growing. Many companies are expanding their operations searching for the new markets since the competition is intense for market shares on the domestic as well as on export markets. The traditional markets are rather saturated compared to the growing prospects and potential demand of the emerging markets.<sup>88</sup> Moreover, the national government policies of some countries affected the global pattern of the automobile production forcing the companies to locate production in particular regions. By introducing tariff and especially non-tariff barriers the governments pursue the goal of building or retaining automotive industry in the country, which is the driving force for the technology transfer, employment, improvement of trade balance and a contribution to GDP.<sup>89</sup>

Latin American market has been experiencing ups-and-downs in automobile manufacturing and sales. Economic volatility, currency fluctuations, devaluation of Brazilian Real in 1999 had an effect on automotive production and sales in the region; consumers' demand declined, investments have decreased and major companies suffered losses. Only after the second quarter of 2000, did the recovery occur and the output started to increase. The structure of industry had to change during last decade as the government policy took a direction towards liberalisation, market opening and regional integration.<sup>90</sup>

### **4.3.2 Brazilian automotive industry**

The historical outlook of Brazilian automotive industry refers to the beginning of 1950's and 1960's when the vehicle production started mainly as kit assembly operations from Volkswagen (VW), Ford, General Motors (GM) and

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<sup>87</sup> O'Keefe, T., Haar, J. (2001)

<sup>88</sup> Ibid

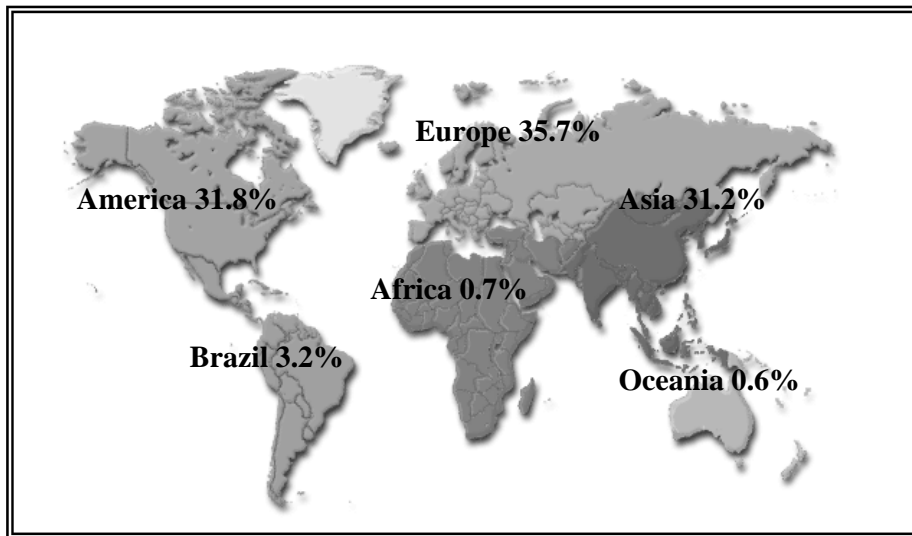
<sup>89</sup> Dicken P. (2001)

<sup>90</sup> O'Keefe, T., Haar, J. (2001)

truck manufacturers Mercedes-Benz and Scania. The protectionist policy of the Brazilian government, high import tariffs forced the companies to locate production there and the vehicle production grew considerably. Today, Brazil is the largest manufacturer of motor vehicles in South America and a significant actor worldwide. During recent years Brazilian automotive industry has experienced dynamic growth and development despite downturns. According to Anfavea, last year the Brazilian automotive industry produced 1 792 660 vehicles, including 68 500 trucks and 22 699 buses, generated US\$16 billion revenue and employed 82 050 people. Today, there are 26 companies producing cars, light commercial vehicles, trucks and buses in 52 operating industrial plants.

*Figure 4.1* gives an idea what place the Brazilian automotive industry takes and how important it is worldwide. It produced around 3.2% of total world production in 2001. As a comparison, the automotive production of the US constituted 20% of world's total, Japan – 17.4%, Germany comprised 10%, France – 6.4%, China – 4.1%, Mexico – 3.3%, the UK- 3%, Italy – 2.8%, Sweden – 0.5%.<sup>91</sup>

***Figure 4.1: Automotive production by continent in 2001***



Source: Anfavea, 2003

<sup>91</sup> ANFAVEA, 2003

It is important to mention that motor vehicles are the main means of transport to move goods and passengers in Brazil. Approximately 60.5% of freight and 96.5% passengers are moved by road, that is why vehicle production is important.<sup>92</sup> Brazil has very sparse railroads, the costs of domestic air fares and shipping costs are very high. Roads are the most important links to other neighbour countries such as Argentina, Uruguay, Paraguay and etc. However, infrastructure is poorly developed and the road conditions need further improvements and investments for development and maintenance.<sup>93</sup>

Brazilian automotive industry is mainly concentrated in South and South East, particularly in the state of Sao Paulo, accounting for two-thirds of the total industrial output. Most of the major vehicle and auto-parts producers are located in the states of Sao Paulo, Minas Gerais and Paraná together accounting for 85.7% of the automotive production.<sup>94</sup>

In order to get an overall picture of automotive industry, it is important to describe auto-parts industry in Brazil, the main trends and changes that have happened recently. Automotive components industry is affected by the new automobile producers' strategies, which require components producers to establish production near their factories with the aim to reduce costs and allow the necessary flexibility in order to adjust their production to unpredicted market variations. There is a large number of mergers and acquisitions of auto-parts producers as a response to global trends and increased international competition.<sup>95</sup> Most of the auto-parts producers in Brazil are foreign-owned at the moment. The industry performance has been uneven during recent years and total sales in 2002 dropped by 8% compared to the previous year. Sindipeças (Sindicato Nacional da Indústria de Componentes para Veículos Automotores), National Association of Auto-parts Manufacturers, estimated value of total sales of about US\$11 billion in 2002, which accounted for 2.4% of GDP, the industry employed about 168 thousand persons, and trade balance of components experienced a deficit of US\$98 million.

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<sup>92</sup> ANFAVEA (2003)

<sup>93</sup> Andren, M.

<sup>94</sup> ANFAVEA (2003)

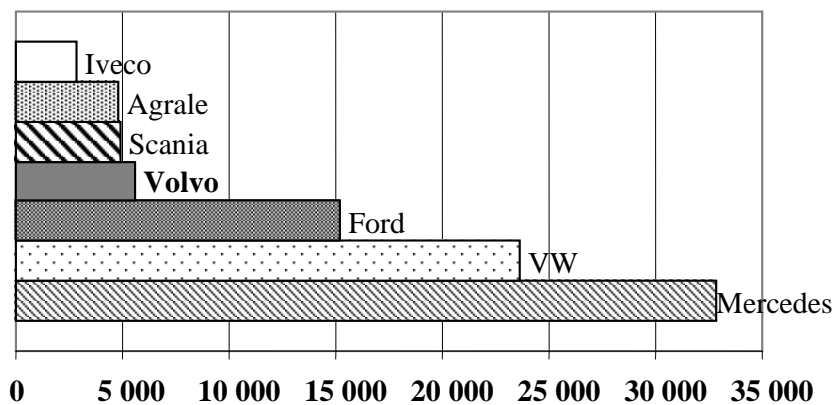
<sup>95</sup> Canada's Business and Consumer Site

### 4.3.3 Brazilian Heavy Duty Vehicle industry

Our particular interest is in the HDV industry as VdB is one of the main actors in this sector. Other main players in the HDV industry are Mercedes-Benz, which is the largest producer in South America, Scania, VW and Ford. It should be noted that Mercedes-Benz and VW have also a bigger market share in the light and medium weight classes trucks whereas Volvo and Scania are more focused in the heavy class.

It is clearly shown in *Figure 4.2* that Mercedes-Benz dominates the HDV sector, followed by VW. The output of these companies accounted for 35.8% and 25.7% respectively of the total in 2002.<sup>96</sup> The companies are strong players on the market and design their products particularly for its needs. Ford takes the third position though it is not presented on the bus sector. It can also be taken into consideration that production volume of lighter weight trucks (6-15 tons) overwhelmingly exceeds the production of heavy trucks. Scania, Agrale and Iveco are the next big players on the market though the volume of production is considerably smaller.

**Figure 4.2: Production of all trucks and buses by main manufacturers in Brazil in 2002**



Source: Anfavea, 2003

<sup>96</sup> ANFAVEA (2003)



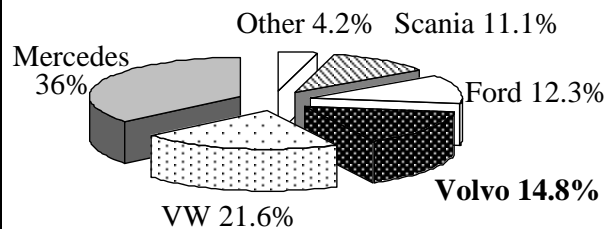
The picture does not change greatly as far as heavy trucks market is concerned. Mercedes and VW are still the leaders in this sector, followed by Volvo. Ford and Scania are also main players in heavy trucks sector.

Brazil is also a large manufacturer of buses in South America. Mercedes-Benz is the biggest bus and coach manufacturer in Brazil, the capacity of which is up to 30 000 chassis per year. This company has a very strong position in the bus sector accounting for 45.8% of all bus sales in Brazil.<sup>97</sup>

**Figure 4.3: Brazilian manufacturers' market share in heavy trucks and buses segments in 2002**

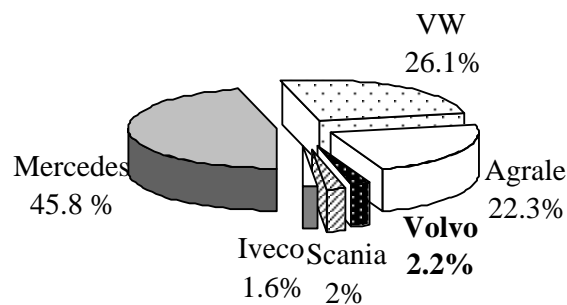
It is not only the leader in the domestic market, but also it is a big supplier to other markets in South America. VW is another significant producer of buses in Brazil. It supplied 4 311 units in the domestic market and exported 695 units in 2002, claiming the second place in the bus segment. Agrale is the producer with the most accelerated production growth rate and according to Anfavea statistics, the sales of buses has been constantly growing from 5 units in 1996 up to 3 691 units in 2002. Volvo is a crucial player in the bus sector, but production and sales of buses dropped considerably in 2002 compared to previous year. The company's domestic sales constituted 514 units in 2001 while the next year the figure fell to 359 units. Scania also performed poorly in 2002 and the share of the market was only 2%.<sup>98</sup>

**Market share of the major truck producers in heavy trucks segment above 15 tons in 2002**



Source: Global Insight Inc., 2003

**Market share of the major producers in bus segment in 2002**



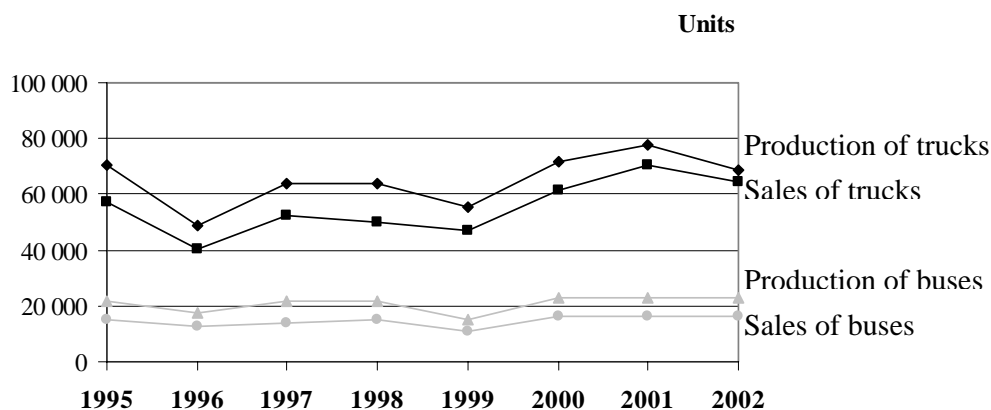
Source: Anfavea, 2003

<sup>97</sup> Jack, D.

<sup>98</sup> ANFAVEA (2003)

In 2001, the vehicle fleet of HDV industry in Brazil was represented by 1 243 thousand units of trucks and 319 thousand units of buses. Total production of heavy commercials accounted for 91 199 units in 2002.<sup>99</sup> The evolution of production and sales of heavy commercial vehicles during 1995-2002 is shown in *Figure 4.4*.

**Figure 4.4: Domestic production and sales of nationally manufactured trucks and buses in 1995-2002**



Source: Anfavea, 2003

The pattern of the production and sales of trucks shows large fluctuations reflecting uneven development of the Brazilian economy. The most notable drop occurred in 1996 as a result of monetary policy applied by the government at the end of 1995 in order to protect the currency from devaluation.<sup>100</sup> Though, the recovery is noticed the next year, the growth was again halted by the financial crisis in 1998-1999 resulting in the decrease of production by 13% in 1999. The whole market went through a difficult period in 1999 because of currency devaluation. The next wave of growth was marked in 2000-2001, when the producers increased the output by 40%. However, the marked rise was followed by a downturn in 2002 and the level of production fell. This can be connected to the economic crisis in Argentina in 2001, which is one of the largest trade partners regarding automotive industry. Sales of the trucks followed the fluctuations of production and were dependent on the overall economic situation in the country. It is predicted that the market for heavy

<sup>99</sup> ANFAVEA (2003)

<sup>100</sup> Andren, M. (1999)

trucks will grow further in the future due to the growth of transportation companies in Brazil. In order to be able to compete, these companies will need to reduce cargo rates, optimising truck capacity utilisation and therefore shifting towards heavier truck purchasing. The share of heavy trucks is expected to increase in the next few years, which is a favourable prediction for VdB.<sup>101</sup>

Looking at the pattern of the buses production and sales, *Figure 4.4* reveals the same trend as in truck performance though the fluctuations were not so high. The biggest drop in bus production was in 1999 as all the other sectors went through, although the sales did not go down considerably. It can be explained by the fact that bus is the popular means of transport and the demand has always been relatively stable. Also, the government forced the companies to renew bus fleets replacing old buses with higher levels of emission in order to struggle with the problem of air pollution in large cities, especially in Sao Paulo.<sup>102</sup> In general, the production of buses grew approximately by 5% in 2002 compared to 1995 and constituted about 22.7 thousand units whereas domestically sold were 16.4 thousand units.<sup>103</sup>

It is important to stress that Brazilian automotive industry is prepared to produce 3.2 million vehicles a year, but today this industry is generating only 1.8 million units a year. Brazil's automotive sector is operating at less than 60% capacity. Quite obviously, Brazilian vehicle manufacturers started searching and approaching new international markets. The answer to the question why Brazilian industry is searching for new markets can be found in the following illustration. In Latin America, Brazil can be compared with Mexico. Automotive industries in both countries produce equivalent amounts of vehicles and are represented by the same automakers. But the great difference is that Mexico mostly produces for export, which accounts about 74% of the total vehicle production, while Brazil mainly produces for domestic market and the share of exports accounts for approximately 23% of the total production. The focus of the Mexican producers is on export markets, particularly the US, which is responsible for 90% of all Mexican exports. Brazil is a typical domestic market with few exports. Brazil's automobile producers are certainly becoming more pro-active in seeking export destinations. That

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<sup>101</sup> Andren, M. (1999)

<sup>102</sup> Ibid

<sup>103</sup> ANFAVEA (2003)

was one of the main reasons that encouraged Brazil to start negotiating trade agreements with other countries to bring opportunities for the local industry to trade freely.<sup>104</sup>

Brazilian automobile producers forced the government through Anfavea to negotiate agreements to increase export potential and have easier access to overseas markets. For many years, the main objectives of Anfavea were internal questions, but during the last few years the situation has changed the core business of Anfavea, putting the international agreements as a first priority. It is also important to emphasise that today Anfavea has strong relations and close co-operation with the government in order to speed up the process of negotiations and discuss the best conditions for industry and country internally and internationally, bringing Brazilian automotive industry to the international scene.<sup>105</sup>

#### **4.4 Trade policy and main trade partners**

Considering *Research Question I*, the investigation is carried out regarding what trade policy Brazilian government has applied during recent years and what potential can arise in the future. It is also identified in this section, what countries are the main trade partners for Brazil in HDV sector in order to distinguish what regional economic blocs to consider later.

##### **4.4.1 General Description**

Brazil's economy remained closed for a long time and extensive government intervention in foreign trade as well as economy's protection has a long history. Only the period of 1990's was marked by significant trade liberalisation, when the government implemented a number of reforms in trade policy, which were still modest compared to other countries of Latin America.<sup>106</sup>

In the early 1950's, the government took the direction of promoting industrialisation in the country, reducing import and encouraging domestic manufacturers to stimulate technological development and to increase employment. The main purpose of trade policies was seen in the accumulation of revenues and improvement of trade balance. A significant change of trade policies occurred in the 1960's when special export incentives were established

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<sup>104</sup> Interview in ANFAVEA

<sup>105</sup> Ibid

<sup>106</sup> US Library of Congress (2003)

and tariffs were cut thus stimulating the growth of trade. During 1967-1973 period, designated as “economic miracle” of Brazil when main economic indicators grew drastically and GDP reached record figures, trade policy remained liberal and continued to open. World oil crisis undermined economic boom and the government was forced to take steps to restrict trade protecting the country and regulating the balance deficit which was unprecedented and reached the figure of US\$4.7 billion in 1974. Import tariff rates were doubled, and further restriction measures were applied to control trade while export was highly supported. The restricted government trade policy showed results ten years later and the effects were mirrored in massive trade surpluses exceeding that of Japan and Germany in 1984. By the end of 1984, the government began to use trade as an instrument to improve internal economic situation which had been shaken with inflation rate of 200%. Brazilian trade policy became more open for imports with reduced control, import surcharges and liberalised import financing requirements. Despite this, the government had to implement various reforms to discontinue inflation and stabilise economic situation. Once again, Brazil experienced trade balance deficit and external payment problems because the exports declined, that is why the government tightened import controls, which were relaxed only in 1986-1988, followed by significant liberalisation in 1991-1994 when Brazilian market became more open.<sup>107</sup>

As the development of the Mercosur framework assisted the elimination of policies and institutions of a closed economy, the automotive sector still remained an exception. Brazil and Argentina defined their own regulations promoting investments and local production of vehicles highly protecting automotive sector.

### ***Trade policy towards import and export***

Although during recent years the policy towards imports has been liberalised, some sectors are still under high protection. Import tariffs are still widely used and subject to further reduction to meet the WTO directions. Tariffs are still above average on beverages, tobacco, furniture, clothing, footwear, and tariff dispersion is mostly high for transport equipment and electronics.<sup>108</sup>

One of the major targets of Brazilian government trade policy has been to promote exports in order to improve trade balance and to offset internal

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<sup>107</sup> Interview in ANFAVEA

<sup>108</sup> SICE (II)

inefficiencies. There are various export financing programmes, export guarantee funds and export credit programmes to stimulate trade flows outside the country but all these programmes are under careful investigation in the WTO. In addition, regional support programmes including fiscal incentives are extensively used by local government for specific sectors particularly for the automotive sector. Export tariffs are not widely used and are almost eliminated.<sup>109</sup>

#### **4.4.2 Trade barriers**

##### ***Tariffs***

Tariff is still the main trade instrument of Brazil. Most of the tariffs are ad valorem, the rates of which range between 0-35%, imposed on the C.I.F. (Cost, Insurance, Freight) value of imports. The average rate applied in 2002 was 11.8% compared to 32% in 1990. Tariffs on raw materials are lower in comparison with finished goods.<sup>110</sup>

In 1995, the CET of Mercosur was introduced to further promote trade liberalisation and reduce tariffs, which covered 8 766 tariff lines with average import duty of 12.7 for nominal tariffs. Since then the CET has been adjusted and by 2000 the number of tariff lines went up to 9 372, but in the period of 1997-2000, called a transitional, almost all tariffs were temporarily increased by 3%. The basic List of Exceptions was created excluding certain goods from the CET, which had to be in force until 2001 in Brazil and Argentina and until 2006 in Uruguay and Paraguay.<sup>111</sup>

Around 90% of intra-regional trade among Mercosur countries is duty-free, with established CET for approximately 85% of imports. However, there is a special tariff regime that has been introduced to the products that are considered “sensitive”, such as automotive products, which applies a country’s own separate external tariff.<sup>112</sup>

It is important to note that even though the four Mercosur-member countries do not apply a common policy regarding trade of automotive products, there are some bilateral agreements establishing policy of automotive trade. There was a

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<sup>109</sup> SICE (II)

<sup>110</sup> US Commercial Service (I)

<sup>111</sup> SICE (II)

<sup>112</sup> Jack, D. et al. (2001)

special regime, the purpose of which was to distinguish the parameters within region increasing efficiency, attracting investments, intensifying competition, in order to prepare the local industry for effective competition, when the market is forced to open up from outside players. This regime will be described further.<sup>113</sup>

#### *Fees and taxes*

When the imports go through the customs clearance, taxes and fees are paid. There are three main taxes that increase import costs and they are *Import Duty* (designated as “II”), *Industrialised Product Tax* (“IPI”), *Merchandise and Service Circulation Tax* (“ICMS”). The description of these taxes is presented in *Appendix II*. In addition, there are miscellaneous taxes and fees to be paid, when the imports are under customs procedures that increase the price of import, representing a barrier to free flow.<sup>114</sup>

When it comes to HDV industry, the Brazilian import tax for buses and trucks is established at the level of **35%** for CBUs imported outside Mercosur countries and from **11.8%** to **15.2%** for CKDs.<sup>115</sup> For the vehicles and auto-parts imported from Mercosur countries, the tariffs structure will be described in the section on Mercosur.

Despite the liberalisation of the market, the automotive sector will be the first target for the government intervention policy stimulating export and reducing import in order to improve Brazil’s trade balance and generate surplus. Having interviewed some main players of the automotive industry, none of them could see the scenario of import tariff reduction in the near future.

#### *Non-tariff barriers*

##### *Customs procedures*

It is worth stressing that there is a trend of reduction of non-tariff barriers in the Brazilian trade policy, but they still remain hidden in various procedures that put obstacles to free trade flows. It can be said in general that Brazil’s import procedures have been simplified with the introduction of a computerised system for customs clearance – SISCOMEX (Foreign Trade Integrated System). However, customs clearance procedures are still inefficient and time-

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<sup>113</sup> Ibid

<sup>114</sup> US Commercial Service (I)

<sup>115</sup> ANFAVEA (2003)

consuming. The average customs clearance time is the slowest compared to other countries in North and South America. It also requires producing a great amount of papers and documentation, which should be filled correctly and a minor mistake can lead to an import prohibition.<sup>116</sup> The requirements of import financing became less tight in 1999 than they used to be, obliging the company “to purchase foreign exchange to pay for imports 180 days in advance or upon importation”.<sup>117</sup>

#### *Import license*

In order to control trade flows, the automatic import licences were introduced in 1997. “Imports subject to non-automatic licensing include products subject to a zero import duty rate, tariff quotas, the drawback regime or the “Law of Similars”, which prevents importation of goods produced locally. The WTO reviews Brazilian import licensing regime and there are discussions between members, but economic reasons stand behind the prohibition of some imports.”<sup>118</sup>

In 1998, administrative measures concerning sanitary/phytosanitary, quality and safety requirements were set up for the *products subject to non-automatic license*. Moreover, the government established additional requirements for the products subject to non-automatic license to be approved for importation.<sup>119</sup>

In general, Brazilian imports are subject to “Automatic import license”, which requires importers to fill the Import Declaration providing information of imported goods including description, harmonised tariff classification number, shipment value, quantity, shipping costs, etc. and all the information is transferred to the computer system SISCOMEX. Import license is issued by The Brazilian Foreign Trade Secretariat (SECEX). Some imports are subject to “Non-automatic license” process when the importer has to provide information before shipment or customs clearance, which is transferred to SISCOMEX system for investigation whether the import license is required.

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<sup>116</sup> US Commercial Service (I)

<sup>117</sup> SICE (II)

<sup>118</sup> Ibid

<sup>119</sup> US Commercial Service (I)



*Local content requirements*

Opening of the market and policy of liberalisation also allowed the companies to procure more outside the country. Local companies were restricted to import components and materials since the local content requirements were very high and only in the late 1980's was the level reduced from 90% to 70% and later on to 60% which is still in force.<sup>120</sup>

It should be noted here that there is a financing programme in Brazil called "FINAMI" offered by the Brazilian Development Bank (BNDES). The benefit of this programme is that the company is granted a loan with a lower interest rate, but there are certain conditions and requirements in order to get the loan. It is obligatory for the companies to keep the local content of at least 60%. According to the companies' point of view, this credit line is of great importance to them to stay in the market and be able to keep sales at a certain level financing their clients. Availability of credit is crucial to support sales. Although, it is a national incentive for the companies to expand sales, this financing programme can also be considered as a hidden barrier, since it is tightly linked to the local content.<sup>121</sup>

*Labelling and standards requirements*

There are no strict requirements regarding standards in Brazil, and both American and European standards are acceptable. The importer decides what standards and conformity to apply. Being a Mercosur member, Brazil is taking active part in developing common standards and regulations for all Mercosur countries, that all members have to apply, as well as technical regulations for some sectors including automotive industry.

All imported goods are required to have a Portuguese translation and easily readable information about the products. The labels should be in metric units since it is official measuring system.

There is also a prohibition of imports established by the government or a special control is applied. There is a restriction of import of used machinery and automobiles.<sup>122</sup>

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<sup>120</sup> O'Keefe, T. and Haar, J. (2001)

<sup>121</sup> Interview in VdB

<sup>122</sup> US Commercial Service (I)

#### **4.4.3 Trade and main trade partners regarding automotive (HDV) industry**

##### ***Trade***

Brazilian trade experienced major changes in the period from 1980 until today. The country has always been a major supplier of agricultural products and raw materials, but the composition of the imports and exports has changed these days. Nowadays, Brazil is becoming more a supplier of manufactured goods though agricultural goods are still the main income in the trade balance.<sup>123</sup> Despite Brazil's proximity to South American countries, it develops trade more with countries in Europe and in North America, however, the trade pattern of HDV sector is diverse. With creation of Mercosur, trade flows increased considerably within this bloc and particularly Brazilian foreign trade has grown rapidly with Argentina during last decade.<sup>124</sup> For the major trade partners of Brazil and trade balance see *Appendix II*.

##### ***Exports and Imports***

As shown in the *Figure 4.5*, Brazil experienced trade deficit during 1995-2000. In 2001, there was a considerable growth of exports and it was also supported by stabilisation of economy and governmental policies to encourage export flows outside the country. In fact, by the end of 2002 exports grew at five-fold rate of the previous year and further increase is expected in 2003.

Looking at the trade balance of automotive sector in Brazil, which includes data on export and import of vehicles and auto-parts, it shows a fluctuation throughout the period of 1994-2003. A major factor here is that Brazilian automotive industry is typically domestic and supplies mostly domestic market. Approximately, one-fifth of the automotive production is exported, compared for example with Mexican domestic sales that account for one-quarter of the whole production of vehicles and the remaining three-quarters are exported.<sup>125</sup> The deficit of trade in the automotive sector started to decline in 1999 and this was the point from which surpluses started to grow. The exports performance was significant in this period, while import growth was relatively small compared to the exports growth. Although, the overall share of automobile

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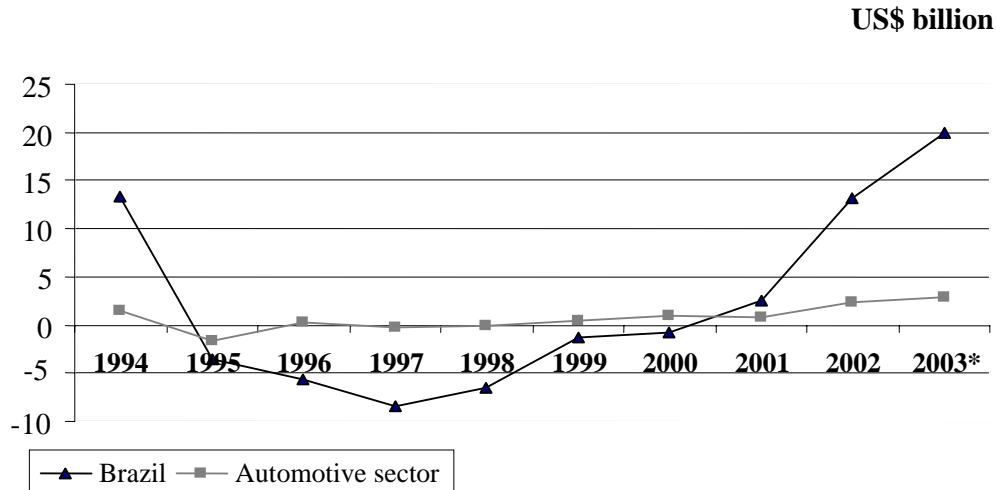
<sup>123</sup> Ministry of Foreign Relations

<sup>124</sup> Brazilian Government

<sup>125</sup> Interview in ANFAVEA

exports is rather modest compared to other countries, Brazil is making an effort to expand its exports and become an international player.

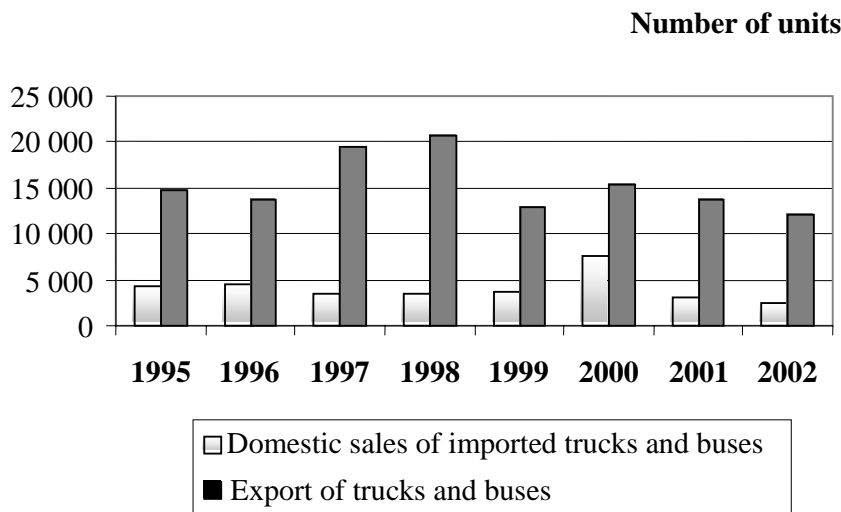
**Figure 4.5: Trade balance of Brazil versus trade balance of automotive sector in 1994-2003**



Source: Anfavea, 2003, \*estimated

In our research, it is very important for us to define in the trade balance the performance of HDV industry as VdB is operating in the HDV sector. Therefore, the exports and imports of trucks and buses should be emphasised from the whole automotive sector. The picture of trade balance of Brazilian HDV industry differs considerably from that of the automotive in general. And, it is clearly shown in Figure 4.6 that the trade is strongly dominated by exports.

**Figure 4.6: Trade balance of HDV industry in Brazil in 1995-2002**

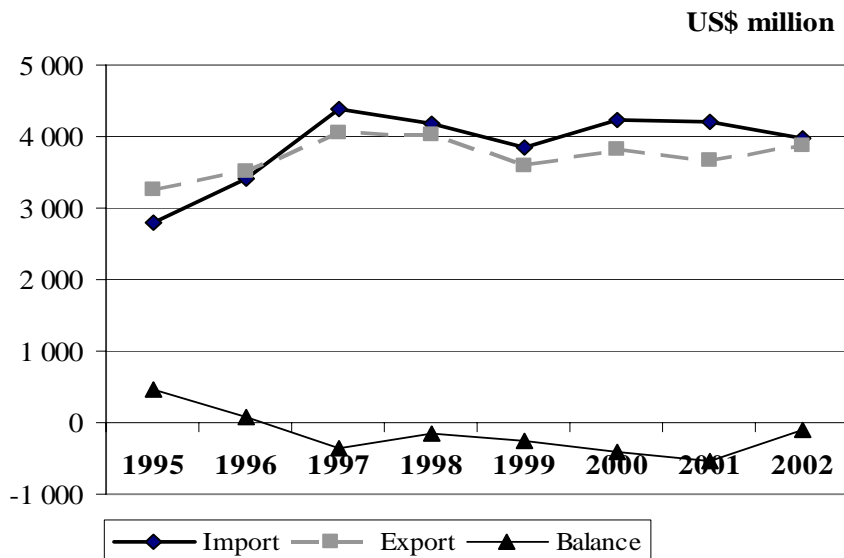


Source: Anfavea, 2003

Compared to the automotive industry trade balance, HDV industry has a spectacular export performance. There is a significant surplus in the trade balance of trucks and buses, exports overwhelmingly exceeded the imports during last 8 years. The most successful year in export performance of the HDV sector companies was 1998, when the exports surpassed the imports at the rate of six-fold. Nevertheless, macroeconomic instability in 1998-1999 was reflected in the exports performance in 1999 and the outcome was a sharp decrease of number of exported trucks and buses though the situation recovered the following year. In general, it can be said that sales outside Brazil dropped by 18% in 2002 compared to the figures in 1995 and there was a continuous decline during last three years, but simultaneously there was also a decline in imports. That was the reason why the surplus was still at a high level.

There is also another sector that should be paid attention to in order to get a clear picture of the sectors that VdB is involved in. Not only VdB, but also other vehicle manufacturers utilise imported components in the production process. Hence, the trade balance of auto-parts is investigated.

**Figure 4.7: Brazilian trade balance of auto-parts in 1995-2002**



Source: Sindipeças, 2003

Note: \*2002 estimated

In the auto-parts sector, the trade deficit implies that components are supplied from outside the country, though the local production is well-developed in the country. The fact, that most of the producers of components in Brazil are multinational corporations (MNCs) and increasing internalisation processes as well as sourcing strategies of major companies, explain an extensive exchange of auto-parts internationally, however, it is noticeable that the imports of components go beyond the exports. *Figure 4.7* shows that Brazilian auto-parts industry has experienced trade deficit since 1996 until today. According to Sindipeças's estimation, the deficit should have shrunk by 72% in the year 2002 compared to the year 1997, but unfortunately, there was no updated data available by the time of writing the thesis.

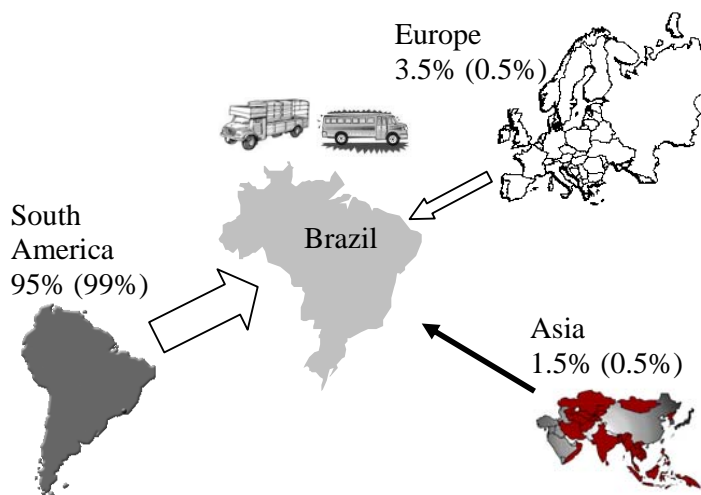
#### ***Main trade partners of Brazil regarding HDV industry***

Geographical pattern of Brazilian trade regarding HDV and auto-parts industry is important to analyse in order to identify the main import and export markets. The most significant feature of trade in the period from 1995 to 2001 was the increase of intraregional trade within Mercosur, since the barriers were diminishing. Today, many companies in Brazil are searching for new overseas markets particularly emerging markets as Mercosur is not a stable economic bloc where the fluctuations of sales are considerable. This did not allow building of a consistent platform to grow production of vehicles and as a result it became very important for the companies to have an access to international markets. The process has begun from pushing the government through Anfavea, to negotiate trade agreements with other countries in order to get favourable conditions to supply those markets.<sup>126</sup>

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<sup>126</sup> Interview in ANFAVEA

**Figure 4.8: Principal import markets of Brazilian HDV industry in 2001 (2002)**



Source: Anfavea, 2003

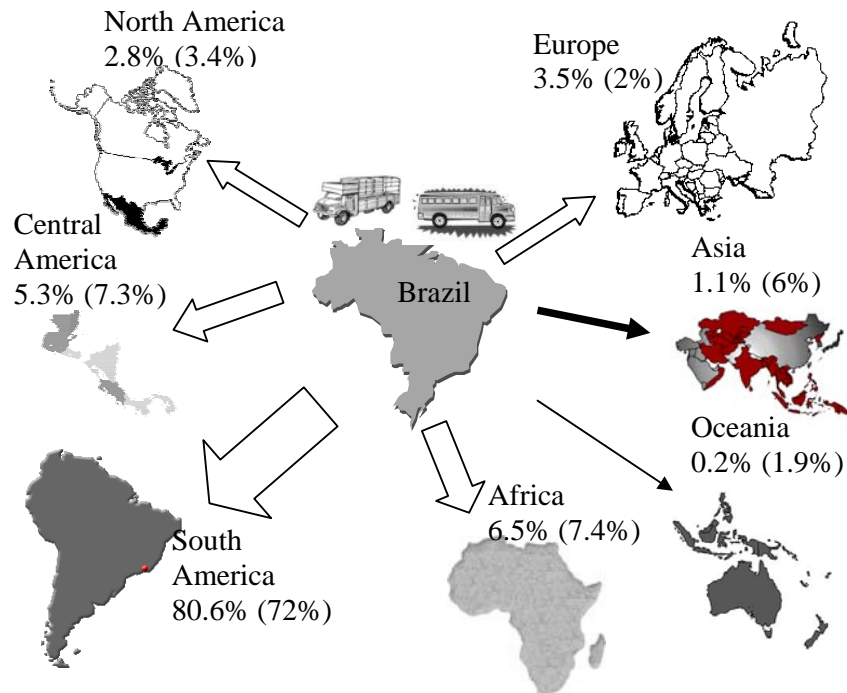
Looking at the pattern of imports, it can be said that the main supplier of trucks and buses in Brazil were the countries of South America constituting 95% and 99% of all imports in 2001 and 2002 respectively. According to Anfavea statistics, all imports came from Argentina and it is mostly intra-company trade. In Europe, France and Italy were the main exporters of trucks to Brazil but when it comes to buses, there were no buses exported from Europe. In the Asian region, Japan is a major supplier of trucks, though it can be assumed that it also implies intra-company trade since all main Japanese automakers are present on the market. It must be emphasised that European and Asian shares of imports had decreased to 0.5% in 2002.<sup>127</sup>

The geography of Brazilian exports is presented in *Figure 4.9*. According to Anfavea, the exports of automakers in Brazil are expected to grow and foreign markets will remain an important target for the companies. There is an increase of investments in production lines intended to supply markets outside the country, although the domestic market will still be important.<sup>128</sup>

<sup>127</sup> ANFAVEA (2003)

<sup>128</sup> O'Keefe, T. and Haar, J. (2001)

**Figure 4.9: Principal export markets of Brazilian HDV industry in 2000 (2001)**



Source: Anfavea, 2003

As it can be seen in *Figure 4.9*, the main destination of Brazilian exports was South American countries. After creation of Mercosur, intra-regional trade grew significantly and Brazilian export flows became strongly oriented towards Argentina, Uruguay and Paraguay. This was principally influenced by establishment of bilateral agreements with these countries since the automotive industry was excluded from the common policies of Mercosur.

The biggest export market for Brazilian HDV industry was South America constituting 80.6% in 2000 but there was a decrease of 7.4% the following year. The biggest recipient of Brazil's exports of HDV in South America were Argentina and Chile followed by Peru, Uruguay and Venezuela. Colombia was a significant importer of buses in 2000 and 2001 accounting approximately 31% of Brazilian total exports to South America.<sup>129</sup> It is difficult to identify the most important markets in South America due to the fact that economies are not stable in these countries. The importance of South American countries changes from year to year depending on some trends, political and economic factors. There are some periods of increasing demand, followed by stagnant or

<sup>129</sup> ANFAVEA (2003)

decreasing demand, but expectations sometimes are decisive. Thus, in order to have stable sales in South America, the companies have to follow and investigate thoroughly where they have opportunities next year and what markets to focus on.<sup>130</sup>

Africa and Central America were the next key export regions after South America. Due to relative proximity, Central America is important market for Brazil, but the size of it is not that big. During 2000 and 2001, Brazilian key export markets for trucks in Central America were Cuba, Guatemala, Dominican Republic and El Salvador, while buses were supplied mainly to Cuba, Costa Rica, Jamaica, and El Salvador's importance grew in 2001. The African market for trucks is represented mainly by the following countries: Nigeria, Angola and Egypt together receiving up to 84% of Brazilian exports of HDV products, Morocco increased its import of trucks from Brazil reaching the figure of 14% of all exports to Africa in 2001. The share of buses represents about 74% of all HDV sector exports to the region and Nigeria was one of the vital markets averaging up to 42% of all bus exports to Africa in 2000-2001, followed by Egypt (25%), Morocco (9%), South Africa (7%) and Angola (5%). The growth of Asian market in 2001 is designated by the growth of bus exports to this region, particularly sales increased in Jordan, Saudi Arabia, and Arab Emirates. It is important to stress that Malaysia, Kuwait and China also improved their position and increased bus imports in 2001.<sup>131</sup> The markets of Europe and North America did not import HDVs from Brazil to a greater extent than other regions. The only market in North America where buses were supplied was Mexico that received all Brazilian exports. Opposite to this, Europe was focusing on importing trucks and shares of the countries were distributed evenly. Germany, Belgium, Sweden, Holland and Spain were the key importers of trucks. The most striking feature is that Brazilian exports to Europe represent intra-firm trade, since all European auto makers established production in Brazil with the purpose to supply domestic market. Finally, Oceania is represented mostly by Australian market that received both trucks and buses from Brazil in 2001.<sup>132</sup>

The pattern of auto-parts export and import distribution differs considerably from that for vehicles. *Figure 4.10* indicates that the major markets for

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<sup>130</sup> Interview in VdB

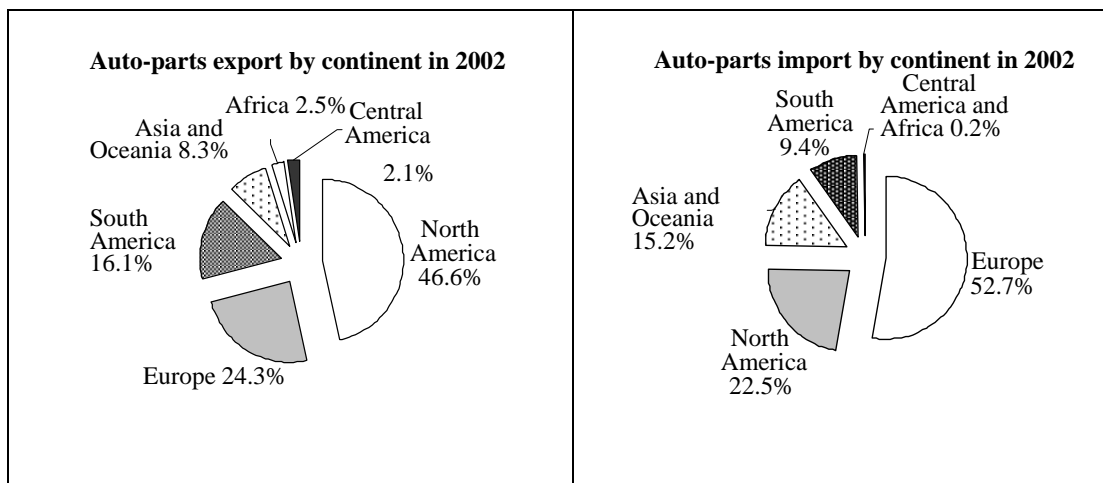
<sup>131</sup> ANFAVEA (2003)

<sup>132</sup> Ibid



Brazilian auto-parts exports were North America and Europe together accounting 63.3% of overall exports in 2002. The dominant position was taken by the US which received more than one-third of all Brazilian auto-parts exports, followed by Mexico. It is also important to stress here that the exports increased compared to the previous years. As shown in the *Figure 4.10*, Europe is the second largest export market where the main countries are Germany, the United Kingdom, Italy and France. The position of South America in the pattern of auto-parts exports is relatively modest compared to export pattern of trucks and buses, but similarly Argentina is the most important market for Brazil in South America, followed by Venezuela and Chile, though its share decreased by half compared to the previous year. China and Saudi Arabia were the countries importing around 8.3% of all Brazilian exports to Asia and Oceania, while South Africa and Costa Rica were the countries of auto-parts exports to Africa and Central America. The role of South American countries in the exports distribution went down in 2002 compared to 2001 and the concentration increased even more on the markets of North America and Europe the shares of which grew by 6% and 2%, respectively.<sup>133</sup>

**Figure 4.10: Principle export and import markets of Brazilian auto-parts industry in 2002**



Source: Sindipeças, 2003

In the pattern of geographical origin of imports, it is clearly shown that Europe is a prevailing supplier of components to Brazil and is responsible for more than a half of all imports to the country. Within Europe, Germany, the United Kingdom, Italy and France are also main importers of auto-parts. The United

<sup>133</sup> ANFAVEA, (2003)

States and Mexico are responsible for around one-fifth of total imports and represent the region of North America. It should be noted that like in export pattern there was a slight increase of share of these regions in 2002, which indicates that these markets are the main export and import partners of Brazil regarding auto-parts industry. Within Asia all major suppliers come from Japan and China accounting for 15.2% of total imports. There was a minor decline of 1.7% of import share of South American countries in 2002, where Argentina and Chile were the main traders. The share of Central America (Panama) and Africa (South Africa) was insignificant in the import pattern and both countries comprised 0.2% of all imports.

## **4.5 Brazilian International Trade Agreements**

*Research Question II* considers the trade agreements that Brazil has regarding HDV industry. This will help to identify what markets VdB can exploit at the moment and where it can obtain benefits. In addition, future negotiations of various bilateral and multilateral agreements between Brazil and other countries are helpful to investigate. This will provide the scheme for scenario building.

### **4.5.1 LAIA-ALADI**

As mentioned in the *Chapter 3*, Brazil is a member of LAIA. This is one of the first regional integrations the country got involved in. The other member countries were mentioned previously. In 2000, the total of exports within LAIA amounted to US\$42 860 million, compared with US\$34 776 million in 1999. These twelve countries together comprised in 2000 a GDP of US\$1 862 billion, in which Brazil and Mexico had a 33% and 31% of input, respectively.<sup>134</sup>

In 1984, the members approved the Regional Tariff Preference with subsequent modifications in 1987 and 1990.<sup>135</sup> This regional tariff preference agreement, whereby the members allow imports from other member states to enter with tariffs 20% lower than third countries, makes LAIA agreement a customs union.

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<sup>134</sup> Europa World Year Book and Volvo do Brasil (2003)

<sup>135</sup> International Labour Organisation (2003)

### ***Principal automotive trade agreements within LAIA / ALADI***

Within this market of around 437 million inhabitants, a certain number of automotive trade agreements are observed.<sup>136</sup> The necessity to strengthen the integration process, aiming at the achievement of the objectives of the Montevideo Treaty of 1980, through the establishment of agreements opened to the participation of the members to create different Economic Complementation Agreement (ECA) or Acuerdo de Complementación Económica (ACE). The agreements in force by the Latin America Integration Area consist of Cuba-ECA 43, Chile ECA-35, Mercosur and its associated members ECA-18, Bolivia ECA-36, Mexico AAP-R-9 (Partial Agreement Protocol) and AAP-CE-55 (Partial Agreement Protocol of Economic Complementation), and Argentina ECA-14.

#### **4.5.2 MERCOSUR**

Mercosur, as a customs union, provides some benefits for Brazil and other member countries. There are also two associate members of this bloc, which are Bolivia and Chile. An “Economic Complementation Accord” with Bolivia which includes this country in the free-trade zone, although not being participant in the customs union, came into force in January 1997. In addition, Chile has the same agreement that came into effect in October 1996, with some duties on a certain amount of products to be removed within a 10-year period. As well as Bolivia, Chile remained outside the customs union, but it was involved in other integration projects since it gives to Mercosur members access to either the Atlantic or Pacific Oceans and likely relationship to the economies of the Far East.<sup>137</sup>

The Mercosur’s free-trade zone came into effect in 1991 removing tariffs from 85% of intra-regional trade. There was a gradual removal of duties with particular products, but the automobile sector remained to be negotiated. The automobile sector constitutes a significant share of the industrial production of Brazil and Argentina. When it comes to the Mercosur’s customs union which came into effect on 1995, it has a CET of 0-23% with a list of exceptions that should gradually meet the requirements by 2006. As mentioned before, the first agreement was signed in the automotive industry within Mercosur and this was not a free trade agreement until today. This trade agreement applies tax free trade, but it controls the balance of trade, thus it is not allowed to export a huge

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<sup>136</sup> UOL (2003)

<sup>137</sup> Europa World Year Book, Volvo do Brasil (2003), SeCIU (2003)

amount of vehicles from Brazil to Argentina without compensating the balance of trade called “trade flexibility”, which will be discussed later.<sup>138</sup>

Some principal macroeconomic indicators, which provide an overview of these Mercosur members, are shown in *Appendix I*. It is observed that Argentina has had some negative performance in its economy due mainly to the Argentina’s economic crisis in 2001. Nevertheless, Argentina together with Brazil still has the higher levels of performance amongst the Mercosur members. This negative impact, most notably in these two countries, caused a rise in local interest rates due to the lack of confidence on the part of the investors. It was the reason to assume rigorous fiscal and monetary measures in order to stabilise the financial markets and undertake a long-term economic growth. These new policies have succeeded in improving the stability of the countries but still there are some recessionary effects in the region.<sup>139</sup>

In 2006, with the perfect customs union, an automotive common policy as part of the “Objectives of Mercosur 2006” should be agreed upon.<sup>140</sup> Furthermore, in this proposal political, social and cultural programmes are described as well as the common market and new integration programme.

### ***Automotive trade agreements***

In the description of the automotive trade agreements within Mercosur, it is important to mention that Brazil, as part of this economic bloc, negotiates in conjunction with the bloc’s other members. Therefore, these countries have experienced some difficulties in the development of a common automotive trade agreement. In 1994, the Mercosur Automotive Regime was created, which ended by December 31<sup>st</sup>, 1999; it was an attempt to create general rules applied amongst member countries (Argentina, Brazil, Uruguay and Paraguay). This comprised bilateral agreements, i.e. ECA-18 (36°) between Brazil - Paraguay and Brazil - Argentina; ECA-02/18 between Brazil and Uruguay; ECA-14/30° and ECA-18/31° between Brazil and Argentina. The current status of the automotive sector is in transition period, which started from 2000 with the Mercosur’s Automotive Policy (PAM) or Common Policy, and the Free Market to be fulfilled by January 2006. The transition period implies reduction of the import tax, restriction of volumes and improvement of the content of

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<sup>138</sup> BNDES (2003) and Europa World Year Book

<sup>139</sup> NYU, Interview in the University of Sao Paulo

<sup>140</sup> Mercosul (2003), Interview in Ministry of Foreign Affairs, Mercosur Division

origin. In the meantime, there has been discussion of certain numbers of attachments to the original ECAs, discounts (40% in import duties to 3<sup>rd</sup> countries), controls, etc.<sup>141</sup>

It should be stressed that the automotive trade balance “flexibility” (Import x Export-US\$) between Argentina and Brazil is not respected. This trade-flexibility will consider the whole automotive sector (including HDV). The volumes that exceed this level shall pay an intra-bloc CET tariff, free of quotas: for vehicles 70% of the import tax and for parts (components) 75% of the import tax. In the “List of Exceptions”, as part of the PAM, the CET will be reduced to 2%. This list is not in force yet. An interesting fact of the trade “flexibility” is due mainly to that even if a company exceeds the limit, the payment of the intra-bloc tariff may not occur. *Table 4.1* shows the opening of the “Trade Flexibility”.<sup>142</sup>

***Table 4.1: Automotive trade flexibility  
between Argentina and Brazil in 2002-2006***

When it comes to the regional content within Mercosur countries, the products from the automotive sector must contain at least 60% of Mercosur regional content.<sup>143</sup> There is an additional requirement of a minimum of Argentinean local content for the production carried out in that country. Also, Uruguay has some export quotas, and the export volumes in excess of the quota will be subject to a diminishing import tax. Within the bloc there are no import duties (free of tax) for Brazilian products, including buses, trucks and components, only the trade flexibility in Argentina above described. In addition, between Argentina and Brazil there is some kind of hidden barrier since you need Argentina’s approval to cross throughout the country as well as special certification in the customs clearance.<sup>144</sup> *Table 4.2* shows the differences between Mercosur members when it comes to the CET to import from 3<sup>rd</sup> countries. As mentioned before, there are some efforts to accomplish CET by 2006.

Year	Export	Import
2002	\$2.0	\$1.0
2003*	\$2.2	\$1.0
2004	\$2.4	\$1.0
2005	\$2.6	\$1.0
<b>2006</b>	<b>FREE MARKET</b>	

*Source: Governmental & Institutional Affairs- Volvo do Brasil. \*Year to Date is US\$1: 1, 15*

<sup>141</sup> Volvo do Brasil (2003)

<sup>142</sup> Volvo do Brasil (2003) and ANFAVEA

<sup>143</sup> Regional Content= 1 – CIF material from 3rd countries / Ex-factory price before taxes

<sup>144</sup> Volvo do Brasil (2003), ANFAVEA, Interview in Daimler Chrysler do Brasil Ltda.

**Table 4.2: Mercosur Import Duties in the automotive transition period 2000-2006**

<i>Brazilian Import Duties (i.d.) - 3rd countries to Brazil</i>			<i>Uruguayan Import Duties (i.d.) - 3rd countries to Uruguay</i>		
Year	Autoparts (three main groups*) %	Trucks and Buses (i.d.) %	Year	Autoparts (limited to the local content**) %	Trucks and Buses (i.d.) %
2002	10.7-12.2-13.8	35	2002	2	11
2003	11.8-13.5-15.2	35	2003	2	13
2004	12.9-14.8-16.6	35	2004	2	15
2005	14-16-18	35	2005	2	17
<b>2006</b>	<b>14-16-18</b>	<b>35</b>	<b>2006</b>	<b>14-16-18</b>	<b>20</b>

*\*\*Regional content must be higher than 50%*

<i>Argentinean Import Duties (i.d.) - 3rd countries to Argentina</i>			<i>Paraguayan Import Duties (i.d.) - 3rd countries to Paraguay</i>		
Year	Autoparts (three main groups) %	Trucks and Buses (i.d.) %	Year	Buses	Trucks
2002	9.8-11.2-12.5	23.6	2002	12	12
2003	10.9-12.4-14	26.4	2003	13	13
2004	12.5-14.3-16.1	29.2	2004	15	15
2005	14-16-18	32	2005	17	17
<b>2006</b>	<b>14-16-18</b>	<b>35</b>	<b>2006</b>	<b>20</b>	<b>20</b>

Source: Governmental & Institutional Affairs- Volvo do Brasil, 2003

\*Three main groups: Parts, subassemblies and assemblies

### **4.5.3 International agreements negotiated by Mercosur in Latin America**

The Mercosur relations with Latin America have contributed to increase the trade between these countries as well as to create a number of bilateral agreements with them. Particularly, Mercosur is a key actor in LAIA's trade relations; this can basically be summed up by a list of three major partners: Chile, Mexico, and Bolivia.<sup>145</sup>

#### **4.5.3.1 Chile**

Chile is very stable market and the prices are very competitive when it comes to buses and trucks. As mentioned before, Chile is involved with Mercosur negotiations as an associate member. Even though, the Treaty of Asunción left

<sup>145</sup> Wanderley, A. et al. (2000)

the door open for the accession of Chile in Mercosur but for various reasons the successive governments of Chile have desisted from making use of that option. They have instead negotiated a free-trade agreement that places Chile free to negotiate as it wishes with the rest of the world and does not oblige Chile to negotiate the harmonisation of its trade policies with the members of Mercosur.<sup>146</sup>

The first agreement with Mercosur-Chile, ECA No. 35, in force since June 1996, has been modified with some amendments which covered an agenda for the automotive free market for vehicles by 2011 and components by 2004. At present, Chilean import tax is based on quotas (units). For example, the quota to export free of import taxes for buses in year 2005 shall be 2 000 units compared with 1 500 units in year 2002. When it comes to trucks, in 2005, it shall be 6 000 units compared with 3 000 units in 2002. In the case that exceeds the quota, the import tax at the moment is 6%; it will remain the same until 2005. The bus chassis, bus bodies and components are free of tax.<sup>147</sup>

#### 4.5.3.2 Bolivia

In 1995 Mercosur reached an agreement with Bolivia providing bilateral preferences, as an opening step toward the final step of a free trade agreement by 2006. The current automotive trade agreement Mercosur-Bolivia, ECA 36, has import duties for Brazilian products for buses of 6% in 2003 compared with 8.0% in 2000. When it comes to import tax for trucks, it is 1.5% in 2003 compared with 2.75% in 2000 free of quotas. The import tax for 3<sup>rd</sup> countries in 2003 for buses and trucks is 13%.<sup>148</sup>

#### 4.5.3.3 Mexico

The relationship Mercosur-Mexico, ECA 55, is seen as a “frame agreement” establishing the needed scenario for a free trade area including some automotive products. The negotiations have effect bilaterally between the five countries involved. In the case of Mexico having the NAFTA membership, its main export market is North America with 90% of the total exports. An incomplete appendix was already signed between Brazil and Mexico, which took four years. This included vehicles with Gross Vehicle Weight (GVW) smaller or equal to 8 845 kg and several automotive parts; the quotas were

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<sup>146</sup> Interview in VdB, Interview at Ford Motor Company, Brasil Ltda., Interview in Daimler Chrysler do Brasil Ltda.

<sup>147</sup> Volvo do Brasil (2003) and ANFAVEA

<sup>148</sup> Ibid

applied also. There is expected to be free trade for these products by January 2006. This negotiation based on quotas does not open the market but it creates the possibility of interchanging some units with zero import tax. Only this amount of units (quotas) is traded without taxes and if it exceeds this amount of vehicles, the import taxes will be imposed. This is a typical trade agreement of the industry in South America. In addition, in Mexico, a plan called PROSEC (Programme of Sectoral Promotion) was developed with the exemption to pre-qualified companies to import parts free of import tax. The disadvantage of this programme is that it is not an international trade agreement; hence it could be cancelled any time.<sup>149</sup>

As a matter of fact, Volvo Bus de Mexico supplies Mexican and Central American markets principally. In VdB, an opportunity is available to supply the North American market through the Mexico plant. This might be supplying some components to Mexican factory to make CKD operations there, this possibility has been studied, but they have not reached any decision yet, since the USA market has more sophisticated products compared with Latin American products.<sup>150</sup>

#### *4.5.3.4 Andean Group (Community)*

The Andean Community bloc consists of Bolivia, Colombia, Ecuador, Peru and Venezuela. As part of this community, the Andean Integration System (AIS) is a group of institutions which is working closely to achieve the main objective in 2006: the common market. It is working with the consolidation of the free trade area (signed in 1988-1993) amongst member countries, the removal of all non-tariff barriers as well as the improvement of the customs union (signed in 1995) in order to complete it. The five Andean countries together have 120 million inhabitants which GDP in 2002 amounted to US\$260 billion.<sup>151</sup>

The Andean Community has a bilateral agreement with Mercosur which was signed in 1998. The main objective was to increase the trade between the blocs and to promote the gradual reduction of all trade barriers. Moreover, a second bilateral agreement was signed in December 2002, it is known as a frame agreement (AAP.CE 56) as an ongoing agenda. Besides, as recently as December 2003, Mercosur and The Andean Community are going to close the

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<sup>149</sup> Volvo do Brasil (2003), ANFAVEA, Interview in ANFAVEA

<sup>150</sup> Interview in VdB

<sup>151</sup> Andean Community General Secretariat and Volvo do Brasil (2003)



basis of the trade agreement, as part of the frame agreement AAP.CE 56, already mentioned, but as it seems, the automotive sector will not be included again, because the specific negotiations did not succeed yet.<sup>152</sup> Mercosur negotiations with the Andean Group have difficulties to some extent. On the one hand, the diversity of arrangements is linked to the various economies of this group, on the other hand, it makes it difficult for them to establish a joint negotiating position.

When it comes to the automotive sector, Andean Community had a CET of 15% in 2003 of import tax for 3<sup>rd</sup> countries for buses and trucks. In addition, the Andean group has bilateral trade agreement with Brazil signed in 1999. In this agreement the “preferences margins” were determined taking into consideration a list of products that were agreed, but the automotive sector was not included in this agreement. As a result, there are some import duties for Brazilian products. For example, Ecuador requires 9.2% for CBUs (buses and trucks) and 3% for CKD, also a 10% import tax for 3<sup>rd</sup> countries and a range from 0% to 15% for components. Peru imposes 7% of import duties for Brazilian products as well as for 3<sup>rd</sup> countries and a range from 6.6% to 12% for components. In July 2000, there was a proposal between Andean Community and Brazil and refers only to the trade between Brazil and each country of the Andean Community, but it was not signed.<sup>153</sup>

The markets in Colombia and Venezuela have been important for VdB, but they have changed due mainly either to the political crisis or new policies in these two countries. Also, the economic instability undermines the competitiveness of VdB, because the imports are increasing and the exports are becoming cheaper, at present it seems more stable, though there are still some negative aspects. The situation in Venezuela today is unpredictable when it comes to sales of buses and trucks. For this reason it is difficult to state what markets have been important during long periods within this bloc.<sup>154</sup>

#### *Negotiation on automotive industry*

Unlike in Mercosur, countries within Andean Community can make separate agreements. Therefore, Venezuela being part of Group-3 and Andean Group have signed an automotive trade agreement with them as well as with Chile.

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<sup>152</sup> Interview in Ministry of Foreign Affairs, Mercosur Division, Interview in ANFAVEA

<sup>153</sup> Volvo do Brasil (2003), ANFAVEA, Interview in ANFAVEA

<sup>154</sup> Interview in VdB, ANFAVEA

Also, there is a bilateral agreement under discussion between Mercosur and Venezuela. It was discussed and determined in July 2000 by Anfavea organisation, the effective term is from 2003 to 2005 to be renegotiated by 2006. The proposal stipulated an import tax for trucks and buses of 5% and 0% for CKDs and the rules of origin will be the content of the Andean Group for the vehicles of Venezuela and the content of the Mercosur for the vehicles of Brazil. When it comes to the volumes of the exports, the increasing yearly quotas shall be established for CKDs as 35 000 units, trucks as 400 units, and buses with 200 units.<sup>155</sup>

## 4.6 Future Trade Agreements under Negotiation

### 4.6.1 Multilateral agreements

#### 4.6.1.1 Free Trade Area of the Americas (FTAA)

As mentioned in *Chapter 3*, the negotiations of FTAA have already started. The FTAA would create an 800 million people market with a GDP of US\$11.5 trillion; it will increase by approximately ten times more by the end of 2010. The principal objective of the negotiations is to work towards the creation of an FTAA by 2005. It is observed that the planned date will include a short time for the integration when there are wide asymmetries in size and economic development of the countries involved.

When it comes to the convergence of development levels, as described before in Mercosur section, it will require particular initiatives in order to undertake a balance among the countries with these disparities. For example, NAFTA and Mercosur, the region's two largest trading blocs, play an important part in the process of integrations amongst the Americas.<sup>156</sup>

The FTAA for the United States means an opportunity of promising markets for its services and knowledge-intensive made products. For Brazil, this trade agreement could likely facilitate access to the U.S. market, and encourage technology transfer as well as increase investment inflows from the United States. However, Brazil has shown some kind of refusal with a delay of the proposed deadline. As a matter of fact, Brazilian economy is changing its interest from domestic stabilisation to the external sector; therefore, it is more

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<sup>155</sup> ANFAVEA, Interview in ANFAVEA

<sup>156</sup> Inter-American Development Bank and Trade Observatory (2003)

interested in increasing exports for continued growth and development. For instance, the FTAA would create an increase in imports, especially from the US and Canada, reducing the country's export performance. The automotive sector would experience some impact being part of this manufacturing export sector.<sup>157</sup> Other issues on which Latin American countries, in particular Brazil, most want the US concessions are in agricultural subsidies and anti-dumping rules since at the present these are off the discussions. Brazil insists that issues such as rules on services, investment and intellectual property should be removed from FTAA and it would be willing to consider regulations on services, but only in line with WTO.<sup>158</sup>

#### *Problems in the consolidation process*

The principal concern of Mercosur government and the FTAA is related to the agricultural aspect. When it comes to the negotiations affecting the automotive sector, they are undoubtedly highly dependent on the success of discussions about agricultural issues, to know whether there will be an attempt to make an agreement inside the automotive sector or not. These agreements might last more than 10 years, since the automotive trade agreements require a transition period until these markets are open completely. There are certain differences, for example, Brazil and Argentina produce 1.8 million and 2 million units respectively compared with the US producing 17 million units. Hence, the negotiation has to be cautious because it is mandatory that the region keeps producing vehicles instead of importing. The general framework of the initial agenda must be kept to complete negotiations for the agreement by 2005, but for an automotive free trade area it will take longer. The fact is that neither Brazil nor other Mercosur countries are independent in the negotiation process; it is also dependent on another sectors, discussions and actors. In the automotive industry, it is seen within the FTAA that rules of origin are the most important point to guarantee a production of vehicles.<sup>159</sup>

The economic and social discrepancies between countries, the environmental and labour rules and the political and economic uncertainty in South and Central America are other factors taken into consideration in the process. The market access will comprise the investment and services in the region, the government procurement, dispute resolution and the central issue, as mentioned

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<sup>157</sup> Inter-American Development Bank, Interview in VdB, Wanderley, A., et al (2000)

<sup>158</sup> Inter-American Development Bank, Interview in VdB, Wanderley, A., et al (2000), FT

<sup>159</sup> ANFAVEA, Interview in ANFAVEA

before, the agricultural matter. In addition, the intellectual property rights, subsidies, antidumping, duties and competition policy are being discussed.<sup>160</sup>

#### *Programme schedule*

In year 2002, the negotiations started on methods and procedures regarding the base tariff, base year, access to the markets, etc. Currently, there have been certain meetings with the Commercial Negotiation Committee for the definition of the base tariff to summarise the points discussed in 2002. In November 2003, there were meetings in the agenda with the American Business Forum and FTAA Ministerial in Miami, Florida, USA. In these meetings, the deadline was discussed for the conclusion of negotiations in January 2005 as well as for the implementation by December 2005 of the FTAA to come into force by 2006.<sup>161</sup>

#### *4.6.1.2 Mercosur – EU*

##### *Background of relations*

The relations between the EU and Mercosur started from the beginning of the Mercosur creation and in December 1995 these blocs signed an “Inter-regional Framework Co-operation Agreement”. The main objective of it was to create an “Inter-regional association” which implied economic, political, social and cultural partnership, including trade liberalisation with the aim of free trade area creation by 2005.<sup>162</sup> Both parties were interested in starting negotiations. The main reason was the fact that Europe was the largest trading partner and investor of Mercosur. Furthermore, the EU’s strategies were focused on emerging markets to have access and to expand European companies’ business on these new markets. Additionally, Mercosur is a big market and the fourth largest economy in the world.<sup>163</sup> According to the assessment of European Commission, this association with Mercosur will bring business opportunities and will have a favourable economic impact.<sup>164</sup>

The negotiations started in November 1999 in Brussels, when the structure of negotiations was approved. Since then 10 Rounds had been held. There were three technical groups created covering issues of:<sup>165</sup>

- Trade in goods, market access and trade barriers

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<sup>160</sup> Volvo do Brasil (2003)

<sup>161</sup> Miami 2003-FTAA (2003), Volvo do Brasil (2003)

<sup>162</sup> Volvo do Brasil (2003)

<sup>163</sup> European Union On-line

<sup>164</sup> Ibid

<sup>165</sup> WTO

- Trade in services, intellectual property rights, capital flow and investments
- Government procurement, competition policy and dispute settlement

The last negotiations by the time of writing this thesis took place in Brussels in November 12, 2003, where the plan of final phase of negotiations was discussed.

### *Trade*

During recent years trade grew substantially between the EU and Mercosur. Although, Mercosur is the biggest trading partner in South America, its share of the total imports is still small. Conversely, the EU is a very important trading partner for Mercosur accounting for about one-third of Mercosur international trade. Mercosur is one of the main suppliers of raw materials and agricultural products to the EU, whereas manufactured goods, machinery and transport equipment are supplied from Europe to Mercosur countries.<sup>166</sup>

Brazilian exports in the European market are subject to different restrictions and requirements. Also, there are different barriers that Brazil and other countries in Mercosur would like to be eliminated by the EU. In most cases for agricultural imports, the EU applies some sanitary and phytosanitary restrictions, quotas, antidumping and countervailing duties as well as some technical barriers, for example, warranted labelling requirements.<sup>167</sup>

The EU is also the main trade partner regarding automotive industry that can be explained by the dominance of European auto makers on the Mercosur market. More than 60% of automotive industry output is generated by European automobile manufacturers; moreover, their sales account for approximately two-thirds of total vehicles sales in Mercosur.<sup>168</sup> It must be emphasised that exchange of goods takes place mainly within MNCs. The trade balance of Brazil with the EU of automotive sector including cars, trucks, buses and auto-parts has been negative for the last four years. It is important to stress that trade of components overwhelmingly exceeds trade of CBUs between these regions. When it comes particularly to HDV, exports and imports have a very insignificant contribution to the trade flows.

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<sup>166</sup> European Union On-line

<sup>167</sup> WTO

<sup>168</sup> European Automobile Manufacturers Association (2003)

*Negotiations on automotive industry*

The EU-Mercosur negotiations also include automotive sector. All the discussions concerning automotive industry have been conducted with consultancy and tight co-operation of vehicle manufacturers associations in both blocs, which are European Automobile Manufacturers Association, ACEA (Association des Constructeurs Européens d' Automobiles) and as mentioned above, Anfavea.

Negotiations on the subject of trade started in July 2001, and the EU's and Mercosur's proposal enclosed the following issues:<sup>169</sup>

***Table 4.3: the EU and Mercosur proposals on the negotiations regarding automotive sector***

<i>European Union proposal</i>	<i>Mercosur proposal</i>
<ul style="list-style-type: none"> <li>• EU has presented an offer covering 91% of all trade</li> <li>• Automotive imports from Mercosur: tariff reduction yearly for 7 years for HDV sector</li> <li>• Proposal covered just import tax aspects</li> </ul>	<ul style="list-style-type: none"> <li>• Mercosur has presented an offer covering 83.5% of all trade</li> <li>• 66% of industrial products are considered as “sensitive”, therefore tax reduction will be over a 10 year period, including a large part of automotive industry.</li> <li>• 17% of the most sensitive products including heavy machinery are still excluded from the offer</li> </ul>

*Source: Governmental and Institutional Affairs, VdB, 2003, adapted*

The main points of Automobile Manufacturers Associations in Brazil and in the EU covering automotive issues are presented in the *Table 4.4* below.<sup>170</sup>

<sup>169</sup> Volvo do Brasil (2003)

<sup>170</sup> Ibid

**Table 4.4: Positions of ACEA and Anfavea in the negotiations**

<i>ACEA's position</i>	<i>ANFAVEA's position</i>
<ul style="list-style-type: none"> <li>• Whole automotive sector must be included</li> <li>• Primary objective is tariff and non-tariff barriers elimination</li> <li>• ACEA agrees with gradual Mercosur's market opening</li> <li>• Free access to the European market for Mercosur's automotive products</li> <li>• Technical rules' harmonisation</li> <li>• Negotiations acceleration and advancement</li> <li>• All Mercosur countries must have a single position</li> <li>• Consolidation of Mercosur's Customs Union</li> </ul>	<ul style="list-style-type: none"> <li>• Automotive sector must be taken as "sensitive" and negotiated separately</li> <li>• Asymmetric quota interchange</li> <li>• Progressive tax dismantling and asymmetric preference margin</li> <li>• Regional content 50-60% - non-cumulative during the transition period</li> <li>• Drawback maintenance</li> <li>• Technical standards: keep the current pattern (European / American) until the UN norm is defined</li> <li>• Emissions: rules from the importer country</li> <li>• Mutual certification recognition</li> <li>• Forbidden trade of used vehicles</li> </ul>

*Source: Governmental and Institutional Affairs, VdB, 2003, adapted*

It should be noted that the EU is prepared to open automotive market since the launch of the agreement and make this market free from the very beginning. Opposite to this, Mercosur takes a very protective position and supports the alternative with establishing transition period of 10 years until the market is completely open. During transition period, quotas for tariff free vehicles, principally for cars and light commercial vehicles, will be introduced, which will be increased gradually and completely eliminated when the market is free. In the case of HDV sector, there were no quotas offered. In order to defend the auto-parts industry, Mercosur offered to apply rules of origin at Mercosur level. Another issue to mention is that Mercosur is also insisting that all new members of the EU accept all the conditions of the agreement. From the EU perspective, it is also proposing the gradual reduction of Mercosur's tariffs in accordance with defined schedule.

When it comes to non-tariff barriers, discussion has also taken place to remove technical barriers during transition period and both sides agree that this will affect the free trade flow. As mentioned before, customs procedures are not

efficient in Mercosur, and more transparent regulations are essential to increase efficiency, which is also demanded by the EU. Bureaucracy is an important issue that should be improved by the Mercosur countries, establishing clearly defined rules.<sup>171</sup> Harmonisation of technical rules is needed between the EU and Mercosur, since two standards are still applied in Mercosur. This question is going to take time to discuss, because there are also negotiations with FTAA, which can apply American standards. Non-tariff barriers regarding technical regulations of environment protection and safety play an important role in automotive industry. These issues are also taken into account by both sides because they seem to be more strict in the EU rather than in Mercosur. If one looks at the positive scenario of the EU-Mercosur negotiation development, completely free market in automotive sector should be reached by the year 2015, taking into consideration the transitional period of 10 years. Although significant progress has been made, there are still issues under question regarding tariff and non-tariff barriers.

It should be noted that the Brazilian vehicle manufacturers are particularly interested in the fast progress of negotiations concerning trade agreement between Mercosur and the EU, and Anfavea tries to speed up negotiations. The main objective is seen by Brazilian auto makers to increase the exports sales to the EU from US\$4.8 billion to US\$9 billion. If there is a positive scenario, this trade agreement will become the greatest deal in South America and will give a possibility for domestic producers to exploit an important market of Europe.<sup>172</sup>

Even though, the discussions of free trade area are under process, there are some problems and obstacles that slow down the negotiations. The principal problem of both parties is that they are pursuing their own goals and interests. From the Mercosur side, it is very important that trade in agricultural products is liberalised by the EU, eliminating mostly non-tariff barriers such as antidumping duties and subsidising, since they are the vital goods for export to Europe. From the EU side, agricultural sector is considered as sensitive and is likely to be excluded from the agreement, which is not appealing for Mercosur. The success of Mercosur-EU will be highly dependent on the negotiations concerning agricultural issues, which seem difficult to resolve at the moment, because the main hurdle is EU's high protectionism. Mercosur government is interested only in agriculture and the industry side comes as a trade-off of

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<sup>171</sup> European Automobile Manufacturers Association (2003), Interview in Scania Latin America Ltda.

<sup>172</sup> World Market Analysis



agriculture discussions. The market will be open for industrial goods in the conditions of EU's liberalisation of the agricultural sector. Mercosur tries to protect automotive sector to a certain degree in these negotiations because it is crucial for the region to keep production of vehicles rather than importing.<sup>173</sup>

It is also worth stressing that despite all the impediments of the negotiations, the government of Mercosur work closely with the industry and have a positive approach to the negotiations. They try to reach a consensus to accelerate these negotiations that can bring more benefits in their opinion than FTAA.

#### **4.6.2 Bilateral agreements**

##### *4.6.2.1 Brazil - India*

Being one of the largest producers of heavy commercial vehicles in the world, Volvo opened its manufacturing plant for heavy commercial vehicles in India in 1998 and later set up production of buses. The plant has a capacity of 4 000 units per year, which it plans to achieve in the next 4-5 years. This opening coincides with the changing demands of the Indian economy. The production of components, which are supplied internationally, has also been established. Volvo considers India a growing technological country; hence an ideal base for production and global sourcing.<sup>174</sup> As Volvo planned to develop Indian plant further and create a “*key hub for Volvo's global sourcing strategy*”, an agreement between Brazil and India will contribute to the increased intra-company trade between Volvo's plants in these countries.<sup>175</sup>

At present the importance for VdB of this market is the opportunity offered due mainly to the competitiveness on this market. In fact, VdB produces according to particular specification to comply with road conditions in South America, thus the trucks produced in Brazil can fit very well in India and also VdB has overcapacity and could supply the Indian market. The main obstacles to export to this market are the costs; because the high import taxes in Brazil make the product less competitive as 30% of components are imported. Second, logistics costs are also a limitation. Today, the material costs represent more than 80% and it is desirable to reduce these costs. But still there is a possibility to compete, because the labour costs in Brazil are cheaper than, for example, in Europe. The cost of the material procured in Brazil is almost the same as in

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<sup>173</sup> Interview in ANFAVEA

<sup>174</sup> Goldwire (2003)

<sup>175</sup> World Market Analysis (2003)

Europe, but the imported material makes the finished product more expensive.<sup>176</sup>

### *Negotiation*

When it comes to the effect of the future negotiations with India, the Indian government has officially manifested interest in negotiating a trade agreement, particularly in the automotive sector. Interest has been shown in some new technologies and an agreement on the reduction of tariffs. In addition, the interest that has been shown by the Indian government for Brazil's Pro-Alcool Ethanol fuel programme- Ethanol Fuel Technology to be exported to India, it would also create for Brazil in return a boost in vehicle exports to India. Recently in June 2003, there was the beginning of the negotiations for an agreement of tariff preferences, for example, the exchange of lists of products had been discussed. The Anfavea and Sindipeças agreed upon the adding up of passenger cars, trucks and components. The time of the conclusion of the negotiations and signing the agreement is still under discussion and the next meeting is expected to be between Brazilian and Indian government in January 26<sup>th</sup> 2004, where the automotive sector will be discussed.<sup>177</sup>

#### *4.6.2.2 Brazil - China*

The interest of VdB in the Chinese market is seen in exports to this emerging market. In the same way as India, the VdB production specifications can match the Chinese market for trucks; hence it can supply to China. The Brazilian government is trying to help provide subsidies, programmes that offer cheap loans with low interest rates in order to finance exports. As a result, VdB is using these loans to increase sales in other markets, especially in the Chinese market. VdB has the competence in producing certain trucks for certain markets. For instance, it can be a complete supplier for China due to an excess of capacity in Brazil and of course the trade agreement negotiations will help to use that capacity. Also, it would be easier to supply the Asian market from China or source them from Latin America, especially from VdB.<sup>178</sup>

China's automotive industry has experienced rapid growth since the country opened up to the world and adopted economic reforms. In addition, China's accession to the WTO has helped to facilitate the development of the

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<sup>176</sup> Interview in VdB

<sup>177</sup> ANFAVEA and Interview in ANFAVEA

<sup>178</sup> Interview in VdB

automobile market, it reduced the import tax of assembled vehicles to the WTO levels - 35% as well as abolished non-tariff barriers. Even with a weak domestic auto industry in comparison with developed countries, China is capable of manufacturing a complete line of automobile products and large automotive enterprises; it will face increasing competition as the market becomes internationalised. China had a total of 2 401 automotive enterprises by the end of 2001.<sup>179</sup>

The VTC has formed a joint venture with China National Heavy Truck Corp (CNHTC) to start building trucks in China by the end of 2003. In 1991, Volvo entered the Chinese market and it sold more than 1 000 trucks in China in 2002 and now it is expected to increase sales in the country. The total Chinese market for trucks over 16 tons GVW is 50 000 units a year, and expected to increase further to 100 000 annually for the next six to eight years. As a matter of fact, there are some trucks that VdB supplies to China, for example, heavy trucks (FM, FH models). In 2001, China imported 55 000 CKDs from Brazilian automotive sector. This was the result of a lower level of tariffs of 25% for components and accessories compared with 70%-80% for vehicles. Unfortunately, the data were not available for CBUs of buses and trucks. Also, China agreed to decrease tariffs on imported components and accessories to 10% over a period of five years, whereby an agreement with WTO was signed in 2001. This stimulated growth of CKDs imports, but today the policy adjustment has been made and only “replacement parts” and accessories are accepted in China under the lower duty level.<sup>180</sup>

### *Negotiation*

When it comes to the automotive trade negotiations, China is on the agenda of the Brazilian automotive industry as a potential market and potential trade pact. In fact, Brazil has reported combined total export of US\$176 million to China during 2001. Meanwhile, Brazil imported just US\$ 14.9 million of goods from China during the year. Given that the major automakers established in Brazil are also established in China, their aim is to strengthen the links between the two countries in order to benefit from a certain exchange of products. This country has not yet made any agreement in the automotive area. In 2002, the government began contacts with China including the automotive industry. There were meetings in Shanghai and Beijing regarding it. The summarised

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<sup>179</sup> US Commercial Service (II)

<sup>180</sup> PRIMEDIA and Interview in VdB

purposes were to introduce to the Chinese government the Brazilian Automotive Sector and the intent to make a partnership with them. In order to harmonise the next steps for the development of the partnership, there was a visit by the Chinese General Deputy of the State Planning and Development Commission to Brazil. The latest meeting of Brazilian automotive industry and the Chinese private sector was in April 2003. This future negotiation is planned to be ended in the next few years.<sup>181</sup>

#### *4.6.2.3 Brazil - South Africa*

South Africa's local manufacturers are mostly assembling vehicles for sale from CKDs and certain amounts of locally manufactured components. When it comes to principal companies in HDV, these are DaimlerChrysler, Delta, Tyco Trucks, Nissan Diesel, Scania, Iveco, Volvo, etc. In 2000, the HDV production totalled with 6 563 compared with 8 039 heavy vehicles in 2002. It should be stressed that HDV industry is weak in South Africa and the fleet of heavy commercial vehicles is old with a very low rate of replacement. The government made an attempt to stimulate faster replacement of old vehicles by introducing special programmes and regulations.<sup>182</sup> South Africa's automotive component manufacturing industry is well-known internationally for its technological sophistication, know-how, and flexibility. It has approximately 220 component manufacturers; much of the component exports are through the local vehicle assemblers.<sup>183</sup>

In the evaluation of the agreement of economic complementation and preferential trade treatment Anfavea proposed to include: cars, light commercials (GVW up to 3.5 tons), commercial trucks (GVW above 3.5 tons), buses, and chassis with engines for buses and trucks. For CKDs, there will be the enclosure of all parts and components listed in the Harmonised Tariff System (WTO). In order to get better results in these negotiations, South Africa's largest automotive manufacturing organisation will be involved with some 200 corporate members, the National Association of Automotive Component and Allied Manufacturers (NAACAM-South Africa) and Sindipeças (Brazil). The rules are similar for both countries, apart from an allowance of a five year period for the accomplishment of 60% of the local content limit. In order to be able to export from South Africa to Brazil, there

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<sup>181</sup> ANFAVEA, Interview in ANFAVEA, World Market Analysis

<sup>182</sup> World Market Analysis

<sup>183</sup> Mbendi (2002), Interview in Volvo do Brasil, Automotive Purchasing News and Volvo do Brasil (2003)

will be a gradual increase up to the 60% level. This increase per year has to be defined in the discussion. The quotas in the proposal are: from Brazil to South Africa for the first year, 40 000 CKDs and 32 000 CBUs. On the other hand, from South Africa to Brazil there will be 108 000 CBUs. The import duty with the limit of quota should be zero as well as for parts and components except for a list of “sensitive items” to be defined.<sup>184</sup>

#### *South Africa position*

The scope to be discussed excludes heavy duty vehicles from the negotiation because of the Motor Industry Development Programme (MIDP) in South Africa. This programme is intended to promote exports, through allowing a reduction of import duties on motor components if they are matched with an equivalent local content value of exported motor components. There is a need to request a list of parts produced in order to analyse an integration possibility. When it comes to the quotas, there exists a disagreement related to CKD units. The suggestion is to be evaluated as quota/value. Also, local content is suggested lower than 60%.<sup>185</sup>

#### *Negotiation*

When it comes to the automotive industry negotiation between Brazil and South Africa, there will be a specific trade agreement. The scheme will give the preference to CKD units' exports from Brazil. In 2001, the representatives of Anfavea visited South Africa and met with the National Association of Automobile Manufacturers of South Africa (NAAMSA), a leading authority in the South African Motor Industry, and government representatives. Consequently, in May 2003 there was a meeting to start the discussion, involving a fixed preferential agreement. Recently in November 2003, the president Luiz Inácio (Lula) da Silva and representatives from the automotive sector from Brazil and South Africa met in South Africa (Pretoria and Johannesburg) to discuss details of negotiation and to define alternatives that both countries might benefit from an automotive trade agreement. As a matter of fact, there are a number of large export contracts under discussion with South Africa, for example, free trade agreements with the European Union and an opening of the American market to South Africa vehicle exports are also taking place.<sup>186</sup>

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<sup>184</sup> Mbendi (2002), Volvo do Brasil (2003)

<sup>185</sup> Autotrim and Mbendi

<sup>186</sup> ANFAVEA, Interview in ANFAVEA, Automotive Industry Export Council



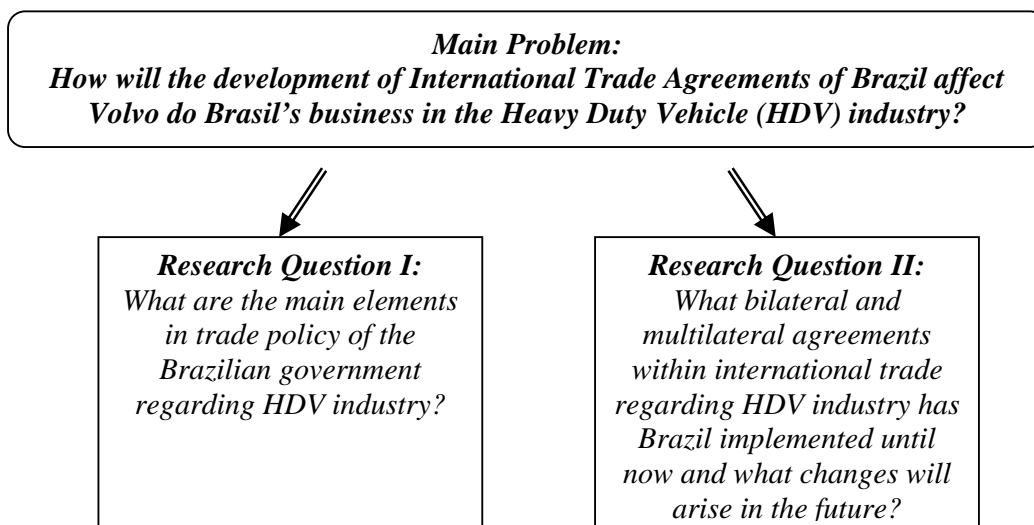
## 5 ANALYSIS

*This chapter creates connection with the research questions in order to respond to the main problem of the study. It carries on a presentation of the strategic implications facing VdB strategies related to the future development of trade policies and the trade agreements negotiations. For the coming sections we shall evaluate the prospective of the trade agreements considering the Brazilian trade policies and the government agenda. Moreover, we shall also take into consideration the automotive sector in general as important stepwise discussion for our specific HDV industry. The future trends of the agreements receive vital concern in this part because they will match with the VdB strategies or current trends which will also be discussed to a certain extent.*

### 5.1 General Overview of the Main Problem

In the previous chapters, the research questions were observed. Their results will help us develop scenarios of future economic integration of Brazil and this further will assist to answer our main problem. As stated at the beginning, *Figure 5.1* will reinforce the discussion about the main problem, as well as the key research questions and the relationship between them.

**Figure 5.1: Main problem and research questions**

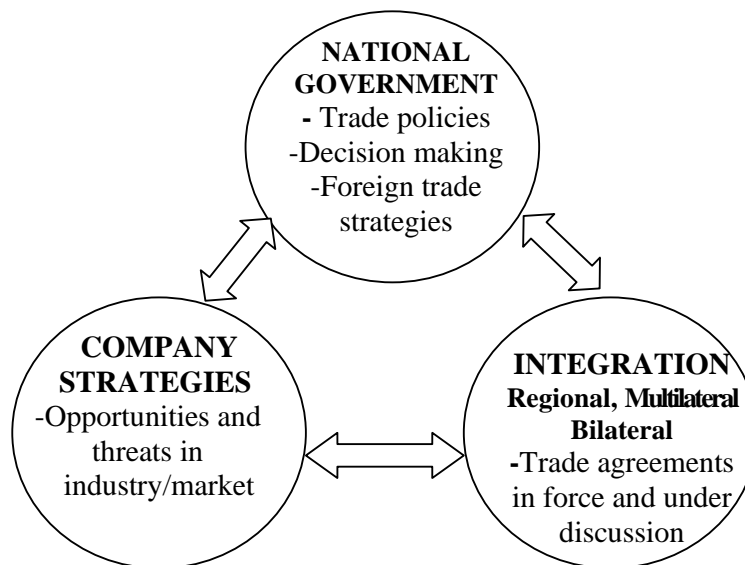


Source: Authors' elaboration

## 5.2 Evaluating the outcome from the relationship of the principal actors

In order to analyse the outcome of our empirical findings the model already mentioned in the *Theoretical Framework* (Figure 5.2) will be used. The model shows the structural relationship of the principal actors taking part in the discussion during the whole thesis. We have identified the main Brazilian's trade partners regarding automotive (HDV) industry as well as an exhaustive comparison of such diverse trade pattern (imports and exports). The main trade barriers were revealed in the trade policy of Brazilian government in order to guide us to *Research Question I*. An explanation concerning the Brazilian's international trade agreements and the prospective negotiations were described, thereby making a certain approach in order to respond to *Research Question II*. The scenarios' development is an essential part in order to foresee a panorama of the advantages and disadvantages with each specific trade agreement. This will lead us to answer our *Main Problem*. Figure 5.2 presents a model according to which an analysis is structured.

**Figure 5.2: Structural relationship of the principal actors**



*Source: Authors' elaboration*

In this part we are going to analyse, according to our model, the current situation in Brazil, starting with the national government and its applied policy towards trade, how this policy has changed and what the priorities it focuses on



at present. The following issue touched upon is the integration processes of Brazil and how the government pressures negotiations, therefore moving to another part of our model, which considers economic integration. The next and the most significant player for our study is VdB and we are going to analyse how its strategy is influenced by the government and integration processes of Brazil, what restraints and benefits it exploits from the governmental current policy and trade agreements in force.

As the investigation shows, prospects for business in Brazil are very optimistic in medium-term, and there is ample room for continued growth in bilateral trade due to the country's tremendous market potential. There is a huge export capacity in the automotive sector, which is not thoroughly exploited. Brazilian vehicle manufacturers still produce mainly for domestic market where the demand is very unstable and highly dependent on economic performance of the country. Therefore, the major strategy of companies is becoming the exploration of the overseas markets and increase of sales outside Brazil. However, the key impediment for most of vehicle manufacturers is the lack of capability to compete globally. This is very well linked to the extreme protectionist policy of the government which restrains local automotive industry from the development in highly competitive world market.

### **5.2.1 Government policy**

The governmental policy has been restrictive for many years. It has chosen this policy in order to create protective environment for the local automotive, including HDV, industry. Although, the import tariffs have decreased compared to the level in the past, they remain high. It is important for the vehicle manufacturers including VdB to put pressure on government to further remove administrative barriers and reduce tariffs that make the production costs higher and a vehicle manufacturer less competitive. One positive factor is that the government policy has changed dramatically during recent years and the directions towards liberalisation and gradual market opening are the main priorities of the governmental policy.

The major tools employed by the government in trade policy are tariffs and they still remain essential barriers that prevent a free flow of goods. Although, non-tariff barriers are intended to diminish, they also affect trade flows. The most notable non-tariff barrier for players in HDV industry is local content requirements, the level of which has decreased compared to the past but still

encumbers manufacturers to procure internationally. Other obstacles to a company trading are poorly developed infrastructure, which complicates the transportation of CBUs and CKDs within country and across borders, and bureaucracy of customs, which extends the delivery time and requires additional costs. These are the main issues that the government should pay more attention to increase efficiency.

As the investigation showed the main trade partners of Brazil regarding HDV industry are countries of South America. It is essential for the automobile manufacturers that the government continues integration processes with South American countries. When it comes to trade in auto-parts, the trade is particularly developed with countries of North America and the EU followed by South America, indicating that the trade agreements would be a significant contribution to the improvement of business operations of automobile producers. The companies consider that these agreements will assist to increase efficiency and to become more competitive. Therefore, the issue of future trade development with these countries and market opening is raised by the industry association Anfavea that demonstrates to the government the importance of these agreements.

It is important to mention that the new president followed the reforms and path of the previous president, who started liberalisation of the economy. If this continues, HDV manufacturers will benefit from favourable conditions for trade and business operations in the future. The tendency, however, is for Brazil to step up exports as part of a more aggressive foreign trade policy on the part of both the former and present administration. In co-operation with the automotive industry and almost “representing industry’s interests” the government implemented external policy starting negotiations with neighbour countries first and later broadened outside the continent. It is a positive signal that the government’s desire is to carry out an active external trade policy and negotiate agreements to boost trade flows between countries. However, it should focus not only on widening, but also on deepening the integration processes in order to give better opportunities for businesses in Brazil.

### ***5.2.2 Regional Integration, Multilateral and Bilateral agreements***

It should be mentioned that although Mercosur was created, there are issues to be dealt with in order to converge. Virtually, Mercosur works as a free trade area despite the fact that it is officially called a customs union. There were

rather political goals than an economic stand behind the integration of these countries. Looking at the policies of the member countries, it is understood that they have to move forward and strengthen co-operation between countries. Trade policies are not harmonised within Mercosur, particularly regarding automotive industry, the reason for this is a big disparity in economic development among countries. As asymmetric treatment is applied in Mercosur it is unlikely to reach a common external policy between its members in the near future. Within Mercosur, the members have bilateral agreements concerning automotive sector considered as sensitive, and trade of vehicles and auto-parts is not free. It has been observed since the creation of this bloc that the governments of each member pursue their own objectives in order to prevent the economy from high fluctuations and protect its local producers.

An ambitious plan “Objectives – 2006” to accomplish customs union covers more political and social issues leaving behind trade and enhanced economic co-operation. Observing the development of Mercosur integration and particularly negotiations on the subject of automotive sector, we can say that there is a low probability to achieve objectives by 2006. We assume that this plan is likely to be postponed as others had been before. The pressure of conflicting objectives on negotiators is such that there are significantly different reasons to sustain. It is observed in Mercosur that Brazil, Argentina, Uruguay and Paraguay are modifying their specific objectives to increase their bargaining position.

As part of the specific objectives, the CAP summarises the main points in the negotiations between Mercosur countries and their automotive industries in the medium and long-term prospects, though there are different objectives in each country in the negotiations with some provisions including rules for managed trade (“trade flex”), common external tariffs, rules of origin and local content. As an example, Brazil is interested in consolidating production scale, while Argentina is concerned about protecting its market from cheaper Brazilian imports, and the two smaller partners had specific position interests. Nevertheless, the commitment of integration and consensus is noticeable. Due to some uncertainties about the evolution of Mercosur, the governments need to define the rules of the game in the automotive sector as soon as possible so that companies can plan their activities and investments with some degree of confidence.

The importance of LAIA for Brazil is not as much as that of Mercosur, though Brazil enjoys the tariff preferences when it comes to trade. Since there is no progress noticed between members to further integrate, the bilateral and other agreements emerged even between members of LAIA like Andean Group and Mercosur that reached a higher level of integration and trade benefits.

Brazilian government has made remarkable progress in expansion of the negotiations with other countries outside Mercosur and also negotiations on behalf of Mercosur. The trade agreements, as mentioned before, are created in order to co-operate and to produce desirable outcomes that are difficult, probably impossible, for individual nations to achieve on their own. In addition, these offer lower protection levels and increase competition, promote trade and help to reorganise the production. All these characteristics might create common preferential rules, economies of scales, greater specialisation, etc.

There is a great amount of negotiations under discussion. It is crucial for the HDV industry in Brazil to be able to trade freely with other countries not only to increase sales on the open markets, but also to exploit specialisation and economies of scale. The biggest projects expected to be accomplished are certainly FTAA and trade agreement with the EU, however, the advancement of these negotiations cannot be assured in short-term. Although, both agreements have major issues to resolve, an optimistic perspective is noticed in the negotiations with the EU. VdB as well as Brazilian government are particularly interested in speeding up these negotiations that will bring benefits for VdB to decrease costs of intra-company trade.

Despite the efforts of the South and North American countries to push the process of hemisphere negotiations, FTAA seems to be under question. Not only the huge disparity of members and broad scope hamper the progress, but also resistance to reach a consensus between two major players which are Brazil in South America and the US in North America.

Other negotiations are focused on the emerging markets. According to VdB, the importance of these markets is growing and predictions are very promising. Brazil is negotiating agreements with China, India and South Africa considering them as big markets with enormous potential mainly for sales of

CBUs and CKDs to some extent, since their domestic automotive industry is not well-developed but in a stage of growth and local producers still do not meet domestic demand. At present, it can be said that out of three countries, negotiations with China can be marked as more advanced, since the talks regarding automotive sector have taken place. Conversely, there is no developed framework of negotiations and proposals with India and South Africa yet. The president of Brazil made his first approach to promote trade and deepen relations planning frequent visits to these emerging markets.

As Mercosur has already negotiated agreements with Andean group, Mexico, Chile and Bolivia, there is a positive prospective to deepen the integration and to open automotive sector to a greater extent. It seems from the investigation that though these markets are close due to geographical proximity and can be the first targets, however, they do not stress the processes of negotiations. Brazilian government tries to widen the geography of trading partners, focusing on other continents.

### **5.2.3 Effects on Volvo do Brasil strategies**

Finally, according to our model, we are going to analyse how VdB's strategy is affected by the national government policy and trade agreements Brazil has.

Protectionist policy of government has influenced the company's operations. Due to high import tariffs and local content requirements, VdB was forced to search for domestic suppliers and choose the appropriate ones in order to sustain the quality that Volvo brand had created. It could not benefit from international outsourcing and it had to develop a production of certain parts inside the plant in order to conform quality standards or reduce costs. Additionally, VdB is restricted from supplying other markets due to inability to compete in terms of price. Although, there are incentives provided by the government to export, the policy in general had more restrictions to which the company had to adjust its operations.

Although, there is a tendency towards integration of Brazil with other regions, South American countries remain very important markets for VdB. This plant is responsible for supplying these particular markets, which VdB is doing at the moment. However, new opportunities can arise with trade liberalisation with other regions. Such geographical re-concentration can occur if the countries in South America do not improve the situation and vehicle manufacturers will

continue to search for other potential to supply and procure from. Brazil is still the most important market for VdB, followed by Argentina and Chile. Even though there is insignificant trade and benefits from the current trade agreements, the position can change in the future. It has already been mentioned before that the company is considering supplying CBUs and CKDs to new markets outside South America if the conditions are changed to be more favourable. Now, the company should put in a lot of effort in order to export, the barriers are seen to be high, which increases costs and undermines the VdB products' competitiveness. High import tariffs for components force the company to reduce level of imported inputs, sometimes strategically important for a company.

It is important to analyse how VdB benefits from the current economic integration with other countries. It seems that Mercosur agreement should have provided a good market of Argentina and smaller ones of Uruguay and Paraguay, but automotive policy is an exception in this bloc. Argentina is the most important market in Mercosur, and although, VdB can trade with Argentina according to established quotas, this agreement does not allow VdB to exploit this market to full extent. However, markets of Mercosur countries provide tariff free quotas and VdB can benefit from it obtaining a greater market access with lower costs and outsourcing some components from this region.

It is important to take into consideration that there are markets that provide preferences for VdB to trade, including Andean Group, Mexico, Chile, Bolivia and Venezuela. As with Mercosur, these agreements are still under negotiation and have a transition period for automotive sector. It means that there is a probability in the future for VdB to reach free trade with these countries, but at the moment there are certain restrictions that the company follows and accepts.

It has been noticed that VdB's sales decreased in South America. In order to work at full capacity, the sales markets should be found that VdB can trade freely with. The fast progress of negotiations of future agreements will bring new opportunities for the company. These future negotiations will facilitate VdB to develop strategies of international outsourcing as well as improvement in economies of scales which in turn will allow to reduce costs and to exploit full capacity. They can also give prospects of expansion to other markets where

its presence is limited. In order to analyse these opportunities in the future, the scenarios have been developed. They cover all the agreements under negotiation and explain the future outcome for VdB.

### **5.3 Scenarios**

The following part is a continuation of the analysis and the aim is to bring on one possible future outcome about the likely future development in the region, emphasising the economic integration, bilateral or multilateral agreements under discussion in Brazil. In the next section different scenarios will be created.

#### **5.3.1 Scenarios' outlook**

In the process of developing the scenarios, we identified four steps as described in the *Theoretical Chapter*. The first step was the *driving forces* with the identification of major forces and factors affecting the future of the international agreements and the VdB business, especially HDV industry. The second was the identification of the important *uncertainties* regarding it. Then, the development of a scenario *framework* was designed. Finally, we present a general description of the *characteristics* involved in each scenario.

#### ***Major factors and forces driving change***

In this section, we proceed to identify the driving forces that will build up our scenarios. The identified forces are designed along with our research approach and thereby show the impact of the different macro economic factors on the future development. We have identified two principal forces: political/government forces and economic forces.

#### ***Political/Government forces***

In the political and government forces, an impact is seen which affects the decisions made by a business organisation. The government can ratify laws that could cause serious harm to specific business sectors. The automotive industry in Brazil has attracted the attention of policy makers with respect to a range of policies, including trade liberalisation/protection, technological upgrading, regional integration, export competitiveness and insertion into the global economy, and economic development. Also, VdB, as part of the business sector, looks at these political forces that might affect them in the short and long term. In addition, the government regulation is the political measures applied to an essentially market-based industry. In light of this role, the main

idea behind Mercosur was to use it as a tool to increase regional bargaining power and to encourage the Brazilian companies to take advantage of it; however, there are certain levels unfinished. Generally, a weak central government would give more power to the protectionists working against an effective performance of reforms. Contrary, a strong government would create a stable political climate and facilitate reform. In the case of Brazil, with the recent election of the President Luiz Inácio (Lula) da Silva, it expected to be pragmatic and stable.

### *Economic forces*

The economic growth has a force in providing to the economy certain stability. It includes decisions made by trade and business organisations. In 1999, Brazil suffered an economic crisis that created high levels of inflation, unemployment, etc. from there the government has put particular emphasis on finding prosperous alternatives in order to not repeat the turmoil. The economy tends to follow business cycles of prosperity, recession, etc. which all impact decisions made by an organisation. When it comes to regional integration, Brazil's government, as part of its strategy, is moving to find new emerging markets in order to correctly assess a new trend to reinforce its economy and accomplish the economic development which will open the market for the business organisation benefiting VdB operations.

### *Uncertainties*

The second step was to identify the forces and factors that are both important in influencing future change and unlikely concerning future outcomes. These factors might have a positive or negative outcome. There were two important uncertainties in order to create the scenarios. The first one was identified as ***“the probability to sign or reinforce the agreement in short-term period”***, meaning short-term period of the next four or five years. Would the probability to sign or reinforce move toward a prospective outcome with market opportunities and high degree of liberalisation and co-ordination? Or would the future negotiation move toward low prospective agreement with low market opportunities and low degree of liberalisation and coordination? The second one is focused directly on the ***“the commitment to integration from both sides”***. Would the commitment to integration from both sides be improved with trade rules emerging and preferable arrangements? Or would the integration

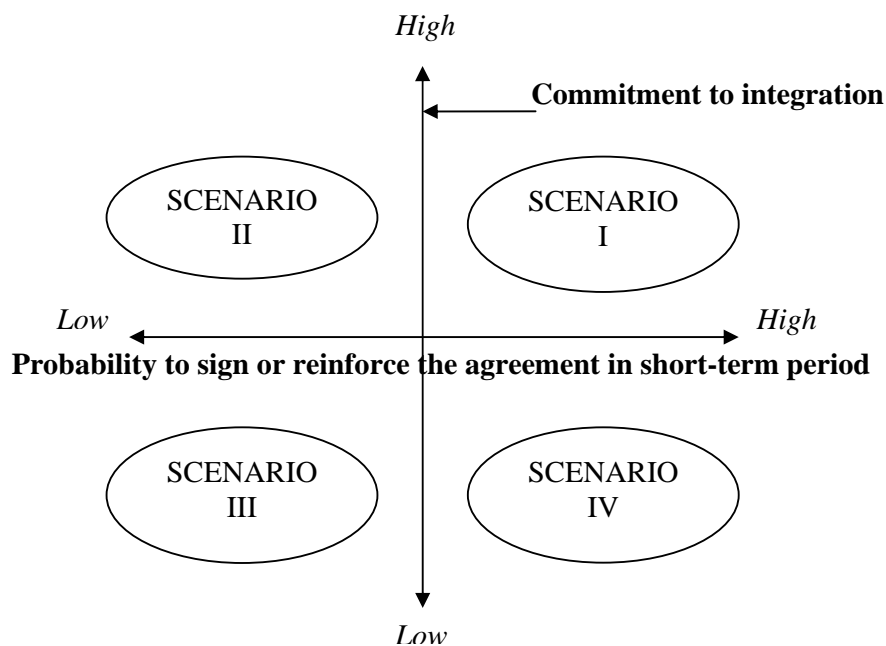


process, that has emerged, be a low automotive mechanism with simple liberalisation programmes?

### ***Scenario Framework***

The uncertainties mentioned above will correspond to the different axes that form the scenario framework where the four different scenarios will take place. Also, this part describes how the dimensions in combination with uncertainties are represented as shown in *Figure 5.3*. The first scenario built in our framework illustrates a high commitment of integration from Brazil and the negotiation under discussion, where the probability to sign or reinforce the agreement is high as well. The second scenario shows that is unlikely to sign the agreement under discussion but a commitment to integration is apparent. The third scenario is characterised by a low probability to sign the agreement, therefore a lack of commitment in such agreements is noticeable. The last scenario exhibits a high possibility to sign the agreement under discussion but with a low level of commitment to integration. This briefing of the scenario framework will be completed by more detailed characteristics of each scenario and the particular case for the negotiations under discussion in the next section.

***Figure 5.3: Scenario framework***



*Source: Authors' elaboration*

### 5.3.2 Scenario I – “Affirmative Actors”

The first scenario illustrates a high commitment of integration from Brazil and the negotiation under discussion, where the probability to sign or reinforce the agreement is high. In this “affirmative actors” scenario we have identified the following future negotiations and prospective: *Chile, Bolivia, the EU, Andean (Venezuela) and Mercosur*. The principal characteristics in this scenario are the interest of consolidating regional/international markets as well as the strengthening of the integration.

#### **SCENARIO I**

- ❖ *Interest in consolidating*
- ❖ *Strengthening of the integration*
- ❖ *Trade rules emerging*
- ❖ *Liberalisation process*

Chile, as Mercosur’s associate member, is seen to strengthen its relationship with Mercosur. The competitive prices in this country and the expected increase for trucks and buses quotas will mean, in short-term perspective for VdB, an increase in exports and opportunities. In addition, VdB should take advantage of trade free of import taxes for bus chassis, bus bodies and components. Also, another positive factor is that this market is geographically close, the transportation costs and time are not a burden. Although, it is a market with favourable perspectives in the near future, VdB should keep in mind that Chilean government policy is noticeably open for international trade with other countries which are not members of Mercosur. It means that it attracts other vehicle manufacturers in other countries to supply this market thus intensifying competition there. Further integration of Mercosur will lead to consolidation of the market and will allow VdB to increase sales and outsource components.

When it comes to the EU, Anfavea is focused on approving the final details of the trade agreement between Mercosur and the EU, thus demonstrating an interest in consolidating. For VdB this agreement will give the opportunity, as a manufacturer, of an important market to deal with and exploit. Despite the fact that the exports and imports of HDV have a very insignificant contribution to the trade flows between these two blocs, the agreement will give the opening for VdB to specialise in production of certain truck and bus models in Brazil and supply to Europe. As VdB imports components from Volvo in Europe, the

trade agreement between these blocs will provide the opportunity of costs reduction, therefore increasing intra-company trade.

Within the Andean negotiation there are certain trade rules emerging, for example, Bolivia will open up to a free-trade agreement by 2006 creating a considerable reduction of import duties for buses and trucks. But even today VdB can enjoy low import tariffs, meaning that the market is quite open and can be taken advantage of. In addition, Venezuela's bilateral agreement under discussion with Mercosur will generate low trade import taxes for trucks and buses and free of import taxes for CKDs. This shows a positive picture for VdB since it will increase the level of exports to Venezuela which before had high import duties for buses and trucks. However, VdB should consider the political crisis or new policies in these countries comprising the Andean bloc.

### 5.3.3 Scenario II – “Dependent actors”

This scenario represents a high degree of commitment to integration with a low probability to sign the agreement in a short-term period. We have called this scenario “dependent actors” since there is a need to establish a formal automotive trade agreement proposal. Therefore, the probability to sign is a cause-effect phase, as a result the cause would be the dependence of the agreement creation and the effect, with a high commitment from both sides, would be the final approval of it.

#### **SCENARIO II**

- ❖ *Market opportunities*
- ❖ *High interest to deal from both sides*
- ❖ *Trade creation*
- ❖ *Undeveloped automotive proposal framework*

The first future negotiation described in this scenario is *China*, depending on the next discussions; it will strengthen the links between VdB and the Volvo's operations for HDV industry in China. In the search for new emerging markets, China offers a variety of advantages for VdB, for example, the market opportunities in this country as well as the trade creation. The latter is increasing the level of trade that results from regional economic integration. Besides, the future negotiation might encourage Brazil's current domestic vehicle market when it is saturated and the country's auto sector is seeking to considerably broaden its export market.

The second country we decided to describe in this scenario is *India*. This country also exhibits the same dependence when it comes to a formal

automotive trade agreement proposal. In India, as well as in China, the market opportunities are wide-ranging. The interest from the Indian and Brazilian government is distinguished, it will boost the vehicle exports to India, and therefore VdB has to pay close attention to the further short-term discussions. This market might be supplied by VdB, as their models comply with road conditions in India and very suitable for the market. These two future negotiations will broaden the VdB portfolio of trading partners commanding the trucks and buses niche.

Despite the fact, that these markets seem attractive for VdB, there are certain threats that the company should consider. These emerging markets experienced growth and showed potential perspectives for vehicle manufacturers to establish production there as the costs are relatively low. As a result, the production output becomes cheaper than vehicles produced in Brazil and additional transportation costs will weaken the Brazilian products competitiveness in terms of price. In short term, when the markets are undersupplied by domestic producers, VdB can make use of it, but in long run, when the local producers are able to satisfy the demand, the situation can ruin the prospects. Though, these two countries can boost intra-company trade for VdB and particularly the exchange of components.

### 5.3.4 Scenario III – “Asymmetric actors”

The third scenario is characterised by a low probability to sign the agreement, therefore a

lack of commitment in such agreement is noticeable. We have called this scenario “asymmetric actors” since there is a spatial arrangement or non-interchangeable or non-proportioned future negotiations become visible. FTAA future negotiation is noticeable in this scenario. The principal characteristics in the scenario are the existence of limited liberalisation objectives, for tariffs, import duties, etc. and the level of harmonisation at present seems uncertain/ambiguous. Moreover, the completion of such agreement is seen as unpredictable because

#### **SCENARIO III**

- ❖ *Limited liberalisation objectives*
- ❖ *Lack of harmonisation*
- ❖ *Unpredictable*
- ❖ *Disparity of economic development*

certain countries comprising the FTAA, including Brazil, perceive that the complete negotiations for the agreement by 2005 will be unsettled, even more, for an automotive free trade area it will take longer.

The FTAA might create trade diversion instead, for example, some of the member countries might alter the trade away from nations not belonging to this bloc. Also, it could result in increase trade with a less efficient producer within the trade agreement and reduce trade with a more efficient one. This for VdB will mean loss of its competitiveness and strong competition with the biggest industry players. In the short-term prospective this agreement for VdB does not have any benefits since there is no well-defined HDV agreement. In long-term future, FTAA will create for VdB a potential market especially for the US and Canada region. Though VdB can experience high competition on these markets.

It can be mentioned that VdB can also benefit from this agreement in terms of costs reduction of intra-company trade with Volvo in Mexico and in the US. These Volvo plants in Mexico and the US supply North American market; therefore there is a little chance for VdB to promote trade of CBUs. However, trucks can be considered for export to Mexico as buses are only in the range of products at that plant.

There is also a threat can arise for VdB with the creation of FTAA. The US automotive industry's output is much greater than that of Brazil; therefore the market opening can encourage the exports of HDV from the US to Brazil, increasing competition on the market.

It is obvious that FTAA will open other markets not only in North, but also in South America. But there are various other agreements between Brazil and South American countries that already provide preferential or free trade for Brazilian manufacturers. That is why FTAA cannot bring great opportunity, especially for HDV industry. In addition, the biggest barrier is that FTAA itself is under question.

#### **5.3.5 Scenario IV – “Low-scope actors”**

The last scenario exhibits a high possibility to sign the agreement under discussion but with a low level of commitment to integration. We have called

this scenario “low-scope actors” since in this scenario the degree of interest, despite to a commitment to

agree in some automotive arrangement, is at a low level due mainly to certain distinctive points. The principal characteristics in the scenario are the high level of isolation for HDV industry/segregation, the resistance from the industry side and the bureaucratic procedures to some extent. We have identified two future negotiations in this scenario; these are *Mexico-Mercosur* and *South Africa - Brazil*.

**SCENARIO IV**

- ❖ *High level of isolation for HDV industry or segregation*
- ❖ *Resistance from the industry*
- ❖ *Bureaucracy*

In the case of Mexico, negotiations due to its implications and complexities could take more time. When it comes to the HDV industry, there is a high level of isolation since if it is approved, this industry is excluded. Moreover, between Mexico and Brazil there is a bureaucratic process interfering with procedures and measures. Low scope of this agreement limits the possibilities for VdB to direct operations towards this market. In the short term, VdB will get the opportunity to trade only bus chassis with Mexico, as the rest is not included. In the long-term prospective, if the framework of this agreement is extended, it will give a chance for VdB to consider Mexico in the future providing the possibility to exploit this market to increase operations efficiency and promote sales.

In the South African ongoing future negotiation, there is some resistance from the South African industry since it would undermine the level of South Africa’s CBUs exports. However, the belief is that an eventual trade agreement, which will reduce South African import tariffs on large-scale Brazilian products, could be negotiated. Also, the South African market will benefit from the imports of CKDs since South Africa’s local manufacturers are mostly assembling vehicles and a certain amount of locally manufactured components. Since these negotiations have not been accomplished, the scenario of an agreement including only CKDs is more likely to happen. This will create for VdB an increase of CKDs exports and components. If the agreement broadens the range of automotive products, the additional CBUs sales opportunities will be provided.

## 6. CONCLUSIONS AND RECOMMENDATIONS

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*The conclusions and recommendations for VdB will be presented in this chapter. This chapter starts with connecting the research questions to each other in order to answer the main problem of the thesis. It combines with a presentation of the strategic implications facing VdB and the HDV industry to the future development of the trade policies and trade agreements in Brazil.*

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### 6.1 Main conclusions on the research questions

In order to answer our main problem, the sub-questions were investigated and the following conclusions can be made to the first research question, which was formulated as:

*What are the main elements in trade policy of the Brazilian government regarding HDV industry?*

In general, it can be said that Brazilian government policy has been liberalised to a greater extent and experienced major changes particularly during recent years. The process of market opening and reforms in trade policy were implemented by the government covering almost all sectors, though automotive (HDV) industry is still protected. However, a gradual reduction of protectionism has been noticed. The policy is mainly directed at the promotion of exports, providing incentives and financing programmes for automotive producers, and at the protection of imports in order to support the development of local HDV industry. High tariffs are applied as an instrument to protect domestic producers and restrict import of heavy vehicles to Brazil. Non-tariff barriers are also widely utilised that limit and impede trade flow.

It is a disappointing feature that the tariff barriers are unlikely to be reduced in the short-term perspective. If the government continues an active foreign trade policy, it will be required to diminish or eliminate these trade barriers under the trade agreements and the WTO rules. Thus, there is a prospect in the long-run for HDV manufacturers to enjoy lower levels of trade barriers or free trade with other countries.

The next extensive investigation covered the integration processes and trade agreements of Brazil; therefore the second research question was developed as:

*What bilateral and multilateral agreements within international trade regarding HDV industry has Brazil implemented until now and what changes will arise in the future?*

Brazil has various bilateral and multilateral agreements with other countries but focus was on the agreements involving automotive sector. Mercosur is the most important and the most advanced agreement for the country. Although, LAIA was formed much earlier, the development of the integration of these countries did not progress significantly. This led to the creation of other blocs and Mercosur was one of them. There are different problems that have to be solved in order to reach a greater integration of the member countries. As automotive sector has received special treatment in this agreement, a number of bilateral agreements emerged within Mercosur, establishing tariffs, quotas and “trade flexibility”. There is no common external policy regarding automotive sector yet, due to resistance of government to open the market and its protectionist policy as well as unstable economic development of the member countries. The investigation showed that Mercosur agreement did not accomplish a free trade agreement in automotive sector and it is still in transition period, though it is planned to be completed by 2006.

The agreements with Chile and Bolivia, two associate members of Mercosur, are still under the free trade agreement and there were no attempts to further integration as both countries prefer to apply their own external policy to third countries. The vehicle manufacturers benefit from tariff preferences at the moment and will obtain more opportunities when the automotive sector is open to free trade in 2006.

A similar situation is noticed in the agreement with Mexico and Andean Group. It should be stressed that although the agreement with Mexico will create a free trade area in 2006, heavy duty vehicles are not included. Therefore, Brazilian players in HDV industry will be able to increase trade only of components. The agreement with Andean Group faces problems of reaching consensus and a



joint position between countries involved in the negotiations. However, there is a certain attempt to establish trade rules, especially with Venezuela.

Brazilian manufacturers took an active position in searching for new export markets in order to increase the utilisation of their capacity, which is not fully exploited as the sales are unstable in South America. This, together with the Brazilian government's intention to promote trade, pushed the development of negotiations. The first step has already been taken and the negotiations started with India, China and South Africa to sign a free trade agreement. The negotiations of FTAA and an agreement with the EU began earlier, but they are unlikely to be accomplished by the arranged time. There are impediments that slow the progress and increase the likelihood of these agreements being postponed; however, the perspective of the agreement with the EU is more optimistic. Both agreements apply a transition period for automotive sector, which indicates that vehicle manufacturers will enjoy free trade only in the long run.

The scenarios development showed that the scenario of “Affirmative actors” represents the negotiations with Chile, Bolivia, Andean Group, the EU and between Mercosur countries regarding automotive trade. The perspective of these negotiations to be accomplished, sign an agreement and implement is higher compared to others in short-term. The countries showed a great commitment and interest to promote trade relations and establish close co-operation. Despite the obstacles in some negotiations, they seem to be moving forward in the negotiation processes.

China and India need time to develop a better framework for the agreements since these negotiations are time-consuming; therefore they are defined in the scenario of “Dependent actors”. There is a better perspective for these negotiations being implemented in the long-term rather than short-term if there are no other obstacles or changes in the government policies or economic instability arises. It is important to mention that both sides show particular interest in creating a free trade area.

The scenario of “Asymmetric actors” is represented by FTAA, where there is low probability to accomplish this agreement by the established date. These

negotiations involve a great number of countries with large disparities in economic development and divergent interests.

The negotiations with Mexico and South Africa are found in the scenario of “Low-scope actors” since the countries are considering the trade promotion and signing or accomplishing trade agreement, but its scope is limited. Both agreements do not cover all automotive issues and exclude HDV sector to a greater extent than others Brazil is dealing with. It is noticed that these negotiations will need a long time until the scope is broadened. Thus, it will not bring many opportunities for HDV manufacturers in the near future.

The whole study and answers to the research questions led us to conclude the main problem, which was formulated as:

***How will the development of International Trade Agreements of Brazil affect Volvo do Brasil’s business in the Heavy Duty Vehicle (HDV) industry?***

The effects of the trade agreements between Brazil and other countries or blocs on VdB operations were illustrated in the scenarios description. To conclude, these effects are generalised. It is seen that there is a positive change in the reforms the national government is implementing in Brazil. A strong expansion of negotiations to stimulate free trade and increase co-operation will certainly result not only in the opening of new opportunities for the company, but also in bringing some threats from increased competition. First, the increased co-operation and elimination of trade barriers within trading blocs and under bilateral or multilateral agreements will allow VdB to increase sales across country borders; there is an opportunity to extend the number of export markets. If there are markets to supply, the company will benefit from the utilisation of full capacity increasing sales revenues and profitability.

Second, the development of international trade agreements will bring the prospect of specialisation of production and costs reduction utilising economies of scale. This can result in the development of production of certain models of trucks and buses that can be supplied globally.

Third, the outsourcing strategy and international procurement can be applied if the trade barriers are released. However, this trend is unlikely to happen in the

near future due to the fact that Brazilian government is still resistant to the rapid tariffs' elimination. This means that VdB will still have higher costs if materials are imported until the agreements are in force and the transition period for automotive sector is over.

## **6.2 Recommendations for the company**

An overall investigation showed that great changes are going to happen in the near future and many trade agreements involving automotive (HDV) sector are going to come into force. 2006 is going to be crucial as a great amount of agreements are planned to be implemented that year if they are not postponed further. That year, the markets will become open and VdB should be ready to meet all challenges they are going to bring.

A common recommendation would be to follow and be constantly aware of all the issues concerning HDV industry in the negotiation processes between the governments of Brazil and other countries. It would be valuable for the company to investigate and evaluate the importance of the negotiations with particular countries and search for opportunities they can bring. Also, the company has to observe the government policy and its directions in order to predict what changes will occur in the future.

Besides, VdB can pursue its interests and goals through the representatives in Anfavea, raising a discussion on matters of interest or the question of negotiating with the government the development or enhancement of trade relations. As mentioned before, Anfavea works in close co-operation with the government on industry strategy development and contribution to the economic growth requesting from the government a guarantee of a policy environment compatible with generating sales and profits in the sector.

It is recommended for VdB to pay particular attention to the process of negotiations with the EU, as this agreement will bring benefits of increased intra-company trade. The processes of integration between Mercosur countries together with Chile and Bolivia are also of great importance to observe since these remain key markets in South America. Other agreements under discussion represent an opening of enormous markets of India and China with which extensive trade can take place. Both markets can be seen as outsourcing and supplying destinations for VdB that will contribute to a broad exchange of complete vehicles and components. Simultaneously, these countries can

represent a danger in terms of price competition, since these are emerging markets demonstrating positive rates of growth and fast development. Therefore, it is recommended for VdB to carry out a careful investigation of these markets and evaluate HDV industry there, which is mentioned in the next section of area for further research.

### **6.3 Area for further investigation**

In our thesis the emphasis was on the aspects of trade liberalisation, development of bilateral or multilateral agreements as well as regional integration and how the Brazilian trade policies affect the company's performance in HDV industry. For further research, it is recommended that the company investigate the situation and evaluate future potential of HDV industries in the countries involved in the future negotiations such as China, India and South Africa. A market analysis would be useful to conduct and a study should be carried out of what opportunities and threats VdB has on these markets.

The government of Brazil is working jointly with the Mercosur member countries in order to explore new and prospective markets. The following are: Russia, Iran, Iraq, Cuba, Libya, Algeria and Morocco. An analysis regarding these markets shall be required in order to investigate and examine its prospects.

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# APPENDIX I

## Macroeconomic Performance of Mercosur- 1999/2003\*

INDICATOR	1999	2000	2001	2002	2003*
<b>GDP Growth %</b>					
Argentina	3.39	-0.79	-4.41	-10.94	5.19
Brazil	0.79	4.36	1.42	1.52	0.50
Paraguay	0.5	-0.4	2.7	-3.9	-1.5
Uruguay	-2.85	-1.44	-3.39	-10.77	-0.15
<b>Inflation%</b>					
Argentina	-1.20	-0.90	-1.10	25.90	6.00
Brazil	4.86	7.04	6.84	8.45	14.89
Paraguay	6.8	9	7.3	10.5	17
Uruguay	5.70	4.80	4.40	14.00	19.50
<b>GDP\$bn</b>					
Argentina	283.42	284.38	267.67	101.11	132.31
Brazil	536.94	601.76	510.66	451.73	500.06
Paraguay	7.71	7.71	7.01	7.14	8
Uruguay	20.91	20.07	18.56	12.33	11.28
<b>GDP per capita \$</b>					
Argentina	7 754	7 679	7 141	2 665	3 445
Brazil	3 198	3 537	2 962	2 587	2 827
Paraguay	1 414	1 343	1 251	940	970
Uruguay	6 332	6 043	5 553	3 669	3 338
<b>Foreign Direct Investment \$M</b>					
Argentina	23 988	11 657	3 214	1 520	450
Brazil	28 576	32 779	22 636	16 600	9 500
Paraguay	95	119	79	40	65
Uruguay	235	274	320	177	105
<b>Current Account Balance \$M</b>					
Argentina	-12 002	-8 869	-4 431	8 954	10 733
Brazil	-28	-26	-25	-8	3
Paraguay	-165	-291	-207	-20	-35
Uruguay	-502	-566	-512	166	280

Source: World Market Research Centre, 2003

\*Forecasting

## APPENDIX II

### *Major trade partners of Brazil and trade balance in 2002*

<i>Major import partners:</i>		<i>Major export partners:</i>		<i>Trade balance:</i>
US	23%	US	24%	<b>Export:</b> US\$60.3 billion <b>Import:</b> US\$47.2 billion <b>Balance:</b> US\$13.1 billion
Argentina	12%	Argentina	11%	
Germany	8%	Netherlands	5%	
Japan	5%	Japan	5%	
Italy	4%	Germany	5%	

*Source: The European Union On-line, 2003*

### *The description of the main taxes levied on the imports that increase import costs*

<i>Tax</i>	<i>Description</i>	<i>Rate for HDV</i>
<i>Import Duty</i> (designated as “II”,)	a product specific tax, imposed on a federal level, after creation of CET, it applies in all member countries, excluding automotive industry	35%
<i>Industrialised Product Tax</i> (“IPI”)	a tax levied on most domestic and imported manufactured goods, assessed at the point of custom clearance on the basis of product importance to the Brazilian user and when the product is sold to end-user, the importer is obliged to pay IPI cost. The higher the import tariff rate, the higher rate of IPI. It should be noted that Brazilian exports are free of IPI tax.	Trucks – 5% buses – 0%
<i>Merchandise and Service Circulation Tax</i> (“ICMS”)	it is a value-added tax imposed by state local government, assessed as ad valorem on C.I.F. value, plus import duty, plus IPI, and is usually incorporated in the price of the product sold to end-users, and paid after the product has been sold. The rate varies according to state and most of Brazilian exports are exempt from ICMS.	12%

*Source: US Commercial Service, 2003*