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Brazil and Mexico, the two largest economies in Latin America, have become embroiled in a nasty trade dispute that threatens to disrupt the cordial relations that the two countries have enjoyed for the past several decades. The trade row erupted when Brazil demanded that Mexico agree to renegotiate an agreement (Acuerdo de Complementación Económica en el sector automotriz, ACE 55) that has kept trade in motor vehicles between the two countries tariff free since 2002 (SourceMex, June 19, 2002). Brazil has proposed imposing tariffs on imports of Mexican motor vehicles and requiring that Mexico import more Brazilian-made trucks and buses. Mexican officials immediately rejected the demands but agreed to hold talks with Brazilian counterparts. The two countries were at an impasse after the first round of talks.

Brazil seeks to reinstate tariffs on Mexican imports

Some analysts say the move to require tariffs on imports of Mexican motor vehicles is an attempt by Brazil to protect its manufacturing base and narrow its trade deficit. President Dilma Rousseff has been raising tariffs and stepping up anti-dumping measures to protect manufacturers hurt by trends in the foreign-exchange market that have fueled a surge of imports in Brazil. The value of Brazil's real has increased significantly against the US dollar since the end of 2008.

At present, Brazil's trade balance in motor vehicles favors Mexico, the third-largest source of cars and trucks for the South American country after Argentina and South Korea. Conversely, Mexico's imports of Brazilian motor vehicles have not increased significantly. The motor-vehicle sector represents about 40% of the total bilateral trade of about US$8.5 billion.

Brazil's daily business newspaper Valor Econômico says the Brazilian government's decision to renegotiate the agreement with Mexico might have been a reaction to trade patterns last year, when imports of Mexican vehicles rose by 40% to about US$2 billion, resulting in a trade deficit of US$1.6 billion in the motor-vehicle sector. The Asociación Mexicana de la Industria Automotriz (AMIA) estimates that half of the nearly 322,000 units exported to Latin America in 2011 were sold in the Brazilian market.

Brazil imposed tariffs on vehicle imports from most other countries at the end of 2011, in an attempt to address the imbalance. The exceptions at that time were Mexico and Argentina, which is Brazil's partner in the Southern Cone Common Market (MERCOSUR). Brazil decided to add Mexico to the tariff regime at the beginning of this year, prompting the current dispute.

Brazil went as far as to threaten to end ACE 55, prompting high-level discussions, including a telephone consultation between President Rousseff and Mexican President Felipe Calderón. "This was a very productive discussion," said Development, Industry and Trade Minister Fernando Pimentel, who participated in the talks. The Brazilian minister said Calderón agreed to talks under which ACE-55 would be reviewed to address the imbalance in automotive trade between the two countries.

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Brazil is proceeding very carefully on this dispute and is trying to avoid gaining a reputation as a protectionist country. "We're considering the use of an exit clause, not breaking the agreement," Pimentel told reporters.

The conversations between the two leaders delayed any immediate action by Brazil, allowing Mexico's Secretaría de Economía (SE) an additional two months to compile and analyze market statistics that could be presented at follow-up meetings as the two sides seek a mutually beneficial solution.

First phase of consultations yields no results

But the openness to consultations does not mean that a resolution to the dispute is imminent. This was evident in statements from Mexican Economy Secretary Bruno Ferrari, who rejected the notion that Mexico would accept any settlement that would require the payment of tariffs on motor-vehicle exports to Brazil. But the Mexican official said Mexico is open to discussions with Brazilian counterparts to reach some compromise. "We want to end these back-and-forth accusations and make sure that we have a clear picture," said Ferrari, who noted that the agreement on automobiles and auto parts has been in place for more than a decade. "During this time Mexico has become a very competitive and balanced partner in a trade relationship that was previously not favorable to us."

Mexico sent a delegation to Brasilia on Feb. 8-10, led by deputy secretaries from the SE and the Secretaría de Relaciones Exteriores (SRE), but the meetings did not result in any concrete agreements. Sources said the Brazilian government is insisting that the ratio of Brazilian auto parts in motor vehicles assembled in that country be set at 30% and is using this measure as a base to determine tariffs. "Mexico opposes that any mechanism for compensation be established because this would be considered a step backward in the market-opening measures established through ACE 55," said the Mexican daily newspaper El Mañana.

But officials for both sides were hopeful that subsequent meetings would result in a compromise. "Our discussions are targeted at finding a consensus that would favor both countries," said an official for Brazil's Ministério das Relações Exteriores. "The initial reunion was technical, and it is very possible that there will be other meetings."

The SE noted that Brazil must recognize that trade relations between the two countries has been cyclical. For example, officials noted that, even though Brazil has a growing deficit in the automotive sector, that county enjoyed a wide surplus in overall trade with Mexico in 2003-2011, which coincides with the period in which ACE 55 has been in effect.

Mexico has gained an unlikely supporter in the dispute with its South American neighbor—Brazil's motor vehicle producers association Associação Nacional dos Fabricantes de Veículos Automotores (ANFAVEA). While ANFAVEA still sees a negotiated compromise as the best solution, the association has expressed strong opposition to the Brazilian government's suggestion that the agreement be scrapped.

"This agreement is very important for our country, and we stated the need to maintain this accord," said ANFAVEA president Cledorvino Belini following a meeting with Nelson Barbosa, an official with the Ministério da Fazenda.

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The same multinational companies, including Germany's Volkswagen and US-based Ford and General Motors, own automobile-assembly plants in both Brazil and Mexico. The factories produce different models in each country, and the vehicles shipped from Mexico are popular models not found in the Brazilian market.

Belini urged the government to consider the big picture and pointed out that, even though Brazil has a trade deficit with Mexico in motor vehicles, the country now enjoys a surplus with Argentina in the same sector. "We had the opposite situation before," said Belini. "These are cyclical things."

Mexico's motor-vehicle sector is adamant that the Calderón administration not accepts any move to reinstate tariffs. "This agreement should not be renegotiated," AMIE president Eduardo Solís Sánchez said in an interview. He pointed out that the agreement allowed bilateral trade to increase significantly between 2003 and 2011 and resulted in a trade surplus for Brazil during the period.

But Solís agreed that it was necessary for both sides to air their grievances during face-to-face discussions. "We want to know what their concerns are," the AMIA president said just before the Feb. 8-10 meetings in Brasilia.

Others were not as diplomatic. Juan Carlos Rivera, who chairs the International Trade Department at the Instituto Tecnológico de Monterrey (ITESM), called Brazil's attempts to renegotiate the agreement "protectionist and outdated." If Brazil moves forward with tariffs, Mexico has the right to demand compensation from Brazil for economic damages to its motor-vehicle industry, said Rivera.

Rivera also noted that if Brazil manages to block imports of Mexican vehicles, those units could easily be shipped to other markets. Argentina, Colombia, Chile, and Ecuador are among the largest customers in Latin America for vehicles assembled in Mexico. But the US is the most important destination, accounting for more than 1.3 million in 2011.

Mexico still eyes full trade agreement

Still, it is in Mexico's best interest to maintain cordial relations with Brazil, since the two countries have discussed negotiating a comprehensive free-trade accord. At the summit of Latin American and Caribbean nations in February 2010, Calderón and former Brazilian President Luiz Inácio Lula da Silva pledged to negotiate a full trade agreement (SourceMex, March 3, 2010), but little progress has been made.

Ferrari still holds hope that the two countries can move in that direction if they get past the dispute on trade in motor vehicles. "Depending on [the automotive issue], we'll see what we can do in the future…to figure out what kind of trade relationship we can have with [Brazil], to see if we can move forward with this specific agreement to establish free trade between our two counties," Ferrari told reporters.

Even without a free-trade accord, the commercial relation between the two countries is already robust. The SE says total Mexico-Brazil trade exceeded US$7.6 billion in 2011.

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