Video Games and the burden of a tax in Brazil: how has the market responded?

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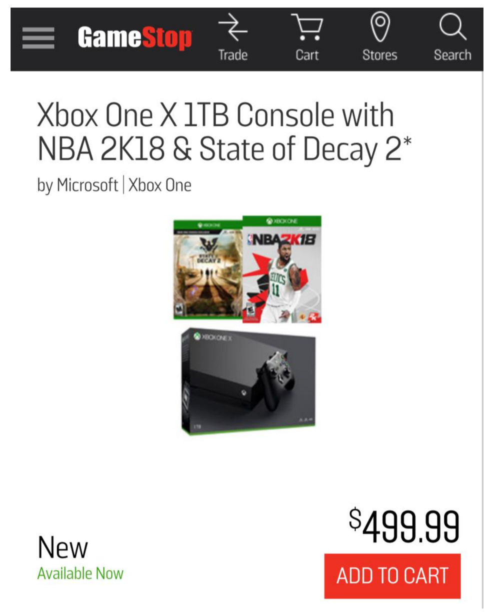
Introduction

At the mall in São Paulo where we exchanged money, I stumbled across a store named Playfields, a Brazilian Gamestop Equivalent. At that store, I noticed that the prices for the Gaming Consoles and Video Games were very high compared to their cost in the USA. The Economist in me came out and I became interested in learning more about why these Video Games are much more expensive and how have players in the Market (Firms and Consumers) responded to these high costs!

On a similar note, another thing I noticed on the trip to Brazil was that almost everything there was Made in Brazil. From computers to cellphones to clothing to children's toys, almost every good that I saw or used carried the "Indústria Brasileira" label on it. I found this to be very interesting because, in the United States, a significant portion of our goods are manufactured overseas! Could this be related to our Video Game inquiry?



The Latest Gaming Console costs hundreds more in Brazil than in the USA!

2,891.99 Brazilian Real equals
767.95 United States Dollar

History: Import Substitution Industrialization

Originally, Latin American countries, including Brazil, were Export Oriented Economies. Many of these countries relied on exporting a limited selection of goods to a limited selection of countries. This worked for a while. However, world events including the Great Depression and World Wars occurred, causing a volatility in the Demand for Latin American exports. As a result, many Latin American Countries changed their strategy to become more of an inward oriented economy that would not be affected by outside market volatility, as had happened when they were open to exports. This new policy was called Import Substitution Industrialization.

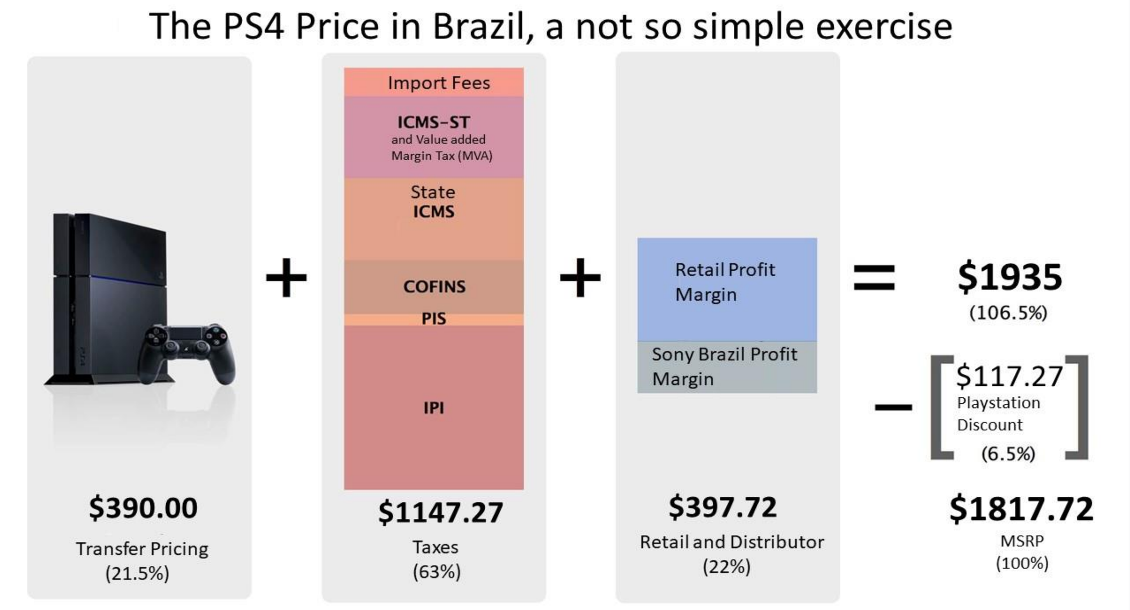
The idea behind Import Substitution Industrialization was to substitute imports from other countries with products made locally to try to spur local industrialization and economic growth. In other words, to try to create a local industry without having to worry about the threat of imports. To accomplish this, high import tariffs were placed along with an overvalued exchange rate, so capital and technology could be imported cheaply.

Import Substitution Industrialization did spur Economic growth in Brazil. From 1940-1979, GDP per Capita grew at a maximum of 6% in Brazil.

Unfortunately, there were many issues with ISI that eventually led to its downfall. The closedness of the economy meant less competition and thus less incentive to care. As a result, many of the factories ran inefficiently and the goods produced were of bad quality. There was also insufficient domestic demand to make Economies of Scale. Goods were often much more expensive because of this. Finally, the Brazilian Government racked up heavy debts because of the inefficiency and bad investments.

Today

As we learned from our visit to Salcomp, the government today continues to be very protective of Domestic Manufacturing. There are still very high tariffs on imports. One of the most notable examples of this is with our Video Games in Brazil. International Video Games such as those from Sega, Sony and Nintendo were not able to enter Brazil until after the ISI Period ended. However, when they could enter the market, many of the Games and consoles were bogged down with heavy import taxes. Take for example, the Playstation 4, which, when launched in 2013, went on sale in Brazil for over $1800 (3,999 Brazilian Reals). This was more than 3 times the cost of the console in the United States ($399). When asked to justify the high cost, Playstation Latin America Responded with the graphic below breaking down the prices:



As can be seen in the graphic, 63% of the cost of the PS4 in Brazil was due to the high taxes that imported goods face in Brazil. Of that 63%, the proportion of the specific taxes are as follows:

Importation tax (II): 20%
This is the standard International Importation Tax and ranges from 0 to 35% typically.

ICMS:
This is a State Tax that is added on goods that must be moved around. Playstation would have to pay this tax because the consoles must be distributed across the Supply Chain in Brazil. This varies from State to State. For example, in the state of São Paulo, Sony would have to pay 25%

Added Value Margin Tax (MVA): 33.54%
Value Added Tax placed by the State Government

PIS: 1.65%
Federal Social Security Tax

CONFINS: 7.6%
Health Insurance Tax

IPI: 50%
IPI is Brazils Industrialized Product Tax. All industrial goods sold in Brazil have this tax, and the rate changes depending on how necessary the government deems the product for society. Essential goods such as paper receive smaller or even no taxes while goods such as luxuries, alcohol and Tobacco are more taxed (Cigarettes are the most taxed at 330%!).

Video Games and their consoles are considered less essential for society, and thus face a higher IPI tax percentage.

How has the consumer responded to the burden of a tax?

The Consumer has responded to these high prices in one of two ways.

First, a black market was created for the cheaper sale and distribution of Video Games and their consoles. Reports suggest that 80-90% of all video games in Brazil are illegally obtained.

Mules often smuggle consoles through one of Brazils many Borders or can pirate and redistribute video games through means like torrenting. In regard to the PS4, around the time of its release, it could be found on the black market for half the MSRP.

A stall selling Illegal Video Games Copies

The second way consumers have responded to the high price for video games and their consoles is to go abroad to buy the goods. This was the tactic suggested to me by the shopkeeper at Playfields.

When the PS4's high price came out, the Brazilian News Source UOL did the math and discovered it was cheaper to travel to the USA and buy the console there than it was to buy the console in Brazil.

Package	Price
PS4 in Brazil	$1817.72
Travel to Miami and buy American PS4	$ 1633.18
Travel to Miami and buy American PS4 + Accessories	$ 1758.18

However, the Brazilian Government has tried to limit this by imposing a tax on goods purchased abroad. Goods other than cell phones, cameras and e-readers (which are considered personal items and are exempt from the following taxation) brought from abroad to Brazil are tax free up to $500. Any goods that exceed that value require a taxation of 50% of the amount higher than $500. If I bought a Computer in the US for $1300, I would have to pay a tax of $400 to bring it to Brazil (50% of $800 ($1300-$500)). Video Game Consoles cost less than $500 in the US though.

How have Firms Responded?

Firms have responded in also in two ways so far.

First of all, Nintendo gave up completely and exited the Brazilian market in 2015 because of the barriers of doing business.

The second way has been to establish Manufacturing Operations in Brazil, which is what the Brazilian Government wants to accomplish with their protective policies. In 2011, Microsoft decided to manufacture their Xbox 360 console in Brazil, allowing the console to be sold for $429.32, much less than the $697.64 MSRP of the imported PS3. As a result, they gained around 85% Market Share in Brazil. This trend likely continued with the future models (the Made in Brazil Xbox One cost $800 less than the PS4) as Sony felt the pressure and opened Manufacturing Operations in Brazil in 2015.

Analysis and Conclusion

While the Brazilian Government strives to protect its Domestic Industry and Economy with High Tariffs, it is the average Brazilian consumer, the people that the laws are designed to protect, who are the ones that suffer the consequences from the Government's Policies. Those imported Gaming Consoles only are accessible to those who could afford them, the very wealthy. This is the same demographic that probably has the funds to get a US Visa and can afford the Airfare to go to the US to shop. Many Brazilians have long noted and complained about this issue, coining the term "the Brazil Cost" for the higher cost that Brazilians must pay for goods in general.

As mentioned before, this has resulted in much revenue loss for Brazil, as Brazilian consumers have resorted to other means of obtaining the goods. The money those consumers spend goes into the International Economy or the Black Market instead. Reports estimate that around $9-10 Billion is spent abroad by Brazilians annually. In addition, around $20 billion is lost to Black Market sales annually.

Finally, just because products are made in Brazil does not mean that the costs will be lessened to the extent that the products are in other parts of the world. Bad infrastructure (many goods, including the PS4 and Xbox One are manufactured in the Manaus Free Zone. With roads like the one we experienced on the ride to the Jungle Lodge, Good luck getting goods to Curitiba), High fuel costs (because of the Government and Petrobras), instability, such as what happened the Trucker Strike during our visit, inefficiency (According to Forbes, factories are much less efficient in Brazil than in other countries) and not enough demand for Economies of Scale to the level of other countries (at Salcomp, we learned that they don't export many of their products Made in Brazil because it is too expensive).

Hopefully, one day, Brazil gets their act together. Reducing the role of the Manufacturing Sector and allowing imports to come in to the level and the way, of other countries such as the United States is a step in the right direction. While there will be job losses, I have confidence that those workers will be reabsorbed back into the Economy in the long run.

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