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BRAZIL INSTITUTE SPECIAL REPORT

BRAZIL AND THE UNITED STATES: TRADE AGENDAS AND CHALLENGES OF THE BILATERAL RELATIONSHIP

Executive Summary

Trade-related challenges between the United States and Brazil continue as the Doha Round stalls. While the future of U.S.-Brazilian trade relations may depend largely on the next administration, it will take more than a party shift in the Oval Office to advance the bilateral relationship. On October 16, the Brazil Institute convened a conference involving several government representatives and trade experts for an open dialogue on Brazil and the United States' trade agendas. Co-sponsored by the Brazilian Center for International Relations (CEBRI) and the National Confederation of Industries (CNI), the event was held on the eve of the 26th plenary meeting of the U.S.-Brazil Business Council in Washington. The three diverse panels of speakers addressed regional and global challenges for Brazil's trade policy, the trade outlook after the 2008 U.S. elections and examined U.S.-Brazil economic relations. Panelists stressed the need for Brazil to shift its strategic trade vision toward a less protectionist agenda and highlighted the need for the United States to overhaul its trade policy in order to redefine its regional and global position.

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Regional and Global Challenges for Brazil's Trade Policy

For President of the Brazilian Section of U.S.-Brazil Business Council *Henrique Rzezinski*, it is imperative both countries shift their political trade agendas toward a strategic vision with realistic expectations of each other and “dismantle taboos” that impede both nations from moving the relationship forward. In Brazil, the issue of trade is tainted by skepticism, given the limitations and demands in both Brazil and the United States to the creation of the Free Trade Area of the Americas (FTAA)—the failed FTAA project was jointly chaired by the United States and Brazil. “The recent evolution of trade policies and their immediate prospects do not offer much reason for optimism. For exactly this rea-



son it is necessary to openly discuss and evaluate the opportunities and modalities considered sensitive to both sides,” said Rzezinski. Vice president for external relations at Embraer and a member of the Brazil Institute Advisory Council, Rzezinski argued that Brazil has been committed to and will continue to advance trade agreements with the United States, especially given the increasing investments made by Brazilian companies in the United States and that of U.S. companies in Brazil.

José Raúl Perales, senior associate of the Latin American Program of the Woodrow Wilson Center, moderated the first panel which focused on regional and global challenges for Brazil’s trade policy. In that discussion, Director of the Center for Integration and Development Studies (CINDES) *Pedro da Motta Veiga* raised questions about Brazil’s “political hyper-activism,” which he said is taking a toll on its trade policy.

Trade policies under Lula have yielded “very timid results,” in large part due to Brazil’s focus on south-south relations and the country’s reluctance to expand its trade relations with the European Union and the United States. For instance, instead of increasing Brazil’s bargaining power, developing country coalitions have constrained Brazil’s offensive interests in the World Trade Organization.

To understand how Brazil’s trade relations with the United States have evolved over the years, one needs to look at its trade history. Traditionally, Brazil’s foreign economic policy has been centered on defensive, protectionist objectives—focusing on isolating the country from external threats and risks. For instance, during GATT/WTO summits, Brazil advocated for preferential treatment to developing countries. This policy approach is derived from a Brazilian mentality that divides the world into developed and developing countries, where each has opposing interests.

Referring to the “New Liberal Decade,” he noted that changes in the global economy throughout the



Henrique Rzezinski

1990s presented new challenges for the country’s traditional trade negotiations framework. Under Fernando Henrique Cardoso’s leadership, Brazil had a more optimistic view of its possible integration in the international economy. Major changes in the private sector brought about increasing demands for market access. As a result of these changes, the country revised the role of government in trade negotiations, focusing on expanding trade liberalization in the services industry and increasing foreign direct investment. At the same time, Brazil was increasingly criticized for its defensive stance in trade negotiations because it barred the agribusiness sector from integrating in the international economy. The conflicting approaches between Brazil’s traditional trade policies and the new, liberal initiatives sparked a policy clash—which was particularly evident when the country participated in preferential trade negotiations with the European Union and the United States. Motta Veiga pointed out that such “clashes” contributed to the failure of the FTAA negotiations.

Now under Brazil’s President Luis Inácio Lula da Silva, these conflicts have been left behind and the

country is once again emphasizing its traditional defensive policy. In Brazil, Motta Veiga noted, trade policy is subordinated to foreign policy goals and preferential negotiations with developed countries are no longer at the top of the agenda. Despite this change in the country's policy position, structural factors in the domestic and international economy are shifting in the opposite direction of Lula's trade policies. Motta Veiga added that trade has resulted in "huge increases" in imports; exports also now account for 30 percent of Brazil's GDP. Moreover, an increasing number of domestic companies are investing abroad. Internationally, new pressures for more aggressive global integration include incentives to include Brazil on international agenda, such as Brazil's active presence in climate change and G-8 debates.

Nowadays, the central assumption for Brazil's trade strategy is that the interests of the north and south are increasingly polarized. Brazil is therefore reluctant to advance a more aggressive international integration policy with the developed world. It fears that this would conflict with its south-south foreign policy strategy and potentially alienate its developing world allies. Motta Veiga observed that as agribusiness continues to grow, Brazil's trade strategy has to make room for new offensive objectives, which may clash with its traditional foreign economic policy of mitigating foreign risks to autonomous development.

"BRAZIL SHOULD NOT MANIPULATE ITS TRADE POLICIES TO ACHIEVE POLITICAL GOALS."



Pedro da Motta Veiga

Motta Veiga argues that domestic and international factors are challenging Brazil's traditional trade policy. The country pursued several initiatives aimed at expanding trade within the Southern Cone. In Motta Veiga's view, pushing for closer south-south relations will likely generate scant economic returns, while the potential political benefits of such strategy remain undetermined. He cautioned Brazil against manipulating trade policies to achieve political goals, citing the country's bid to gain a permanent seat at the United Nations Security Council as one such example.

Maurício Mesquita Moreira, senior trade and integration economist at the Inter-American Development Bank, compared Brazil with emerging economies in Asia, particularly Taiwan and S. Korea. He observed that all three countries experienced substantial economic growth after they started to open-up to international trade. Moreira asserted, however, that in order to expand its presence in global trade, Brazil has to diminish barriers, such as protectionism and high transportation cost, while seeking to open markets abroad.

Since Brazil began lowering import tariffs in the mid-1990s the results have been encouraging.

Within the Mercosur trading block, tariffs are practically zero. Trade has brought down the cost of capital goods, like machinery and equipment, which consequentially reduced the cost of investment.

Protectionism remains a major inhibitor of economic growth in Brazil. The country has high import tariffs on capital goods, especially in comparison to China, Indonesia, Korea and Thailand. As far as other sectors, Brazil's nominal and effective tariffs vary widely in industries as disparate as agriculture and automobiles. Moreira said there's no clear economic justification for all the tariffs, and pointed to "the power of lobbying" as a likely explanation.

Gains from trade depend not only on liberalizing at home, but also on opening markets abroad. In the case of Brazil, the problem in the early 1990s was protection of the domestic market. Overtime, the lack of access to markets abroad also limited growth. Trade policy seems to have been guided by the questionable notion that south-south agreements are inherently good for growth and north-south agreements are risky ventures. This means the country prefers to pursue increased trade within Mercosur over expanding trade with the EU and the U.S. Moreira emphasized, however, having access to a bigger market is essential if Brazil wants to remain an important manufacturing producer.

China and India pay higher levels of tariffs in the U.S. market for manufacturing goods than Brazil. Currently, Brazilian exports pay fewer tariffs to enter Chilean markets than they do for the American market, but Moreira predicted the situation will be reversed due to the U.S.-Chile Free Trade Agreement, which took effect in January of 2004.

Apart from tariffs, another—and more significant—barrier to growth are high transportation costs. Moreira showed data indicating that the high cost of intra-regional transportation in Latin America is due to high tariff levels.



Maurício Mesquita Moreira

Jeff Hornbeck, a specialist in the Trade Division of the Congressional Research Service (CRS), said Brazil has been too focused on its "Mercosur shell," and that has blinded the country from other economic opportunities. Hornbeck expressed skepticism toward the possibility that Brazil will overhaul its foreign trade policy. "Brazil is being completely honest when saying [sic] it is unwilling to compromise Mercosur with wide regional or multilateral agreements unless other countries are willing to meet Brazil's own terms," he explained

Hornbeck criticized Brazil's defensive foreign policy because it fails to consider the demands of its own private sector. Hornbeck referred to a recent article that appeared in Brazil's major newspaper *O Estado de S.Paulo*, in which a senior Brazilian foreign trade official said that if the country had to make a choice between the Doha Round and Mercosur, Brazil would choose Mercosur. The assertion reflects the determination of the Brazilian government to prioritize regional integration. Agriculture subsidies are not the only reason for the failure of the FTAA. According to Hornbeck, Brazil is reluctant to accept

Trade Agendas and Challenges of the Bilateral Relationship

the compromise of opening-up its industrial sectors in exchange for reduced agricultural subsidies in the EU and United States because it fears increased competition will diminish its status as the industrial leader of Mercosur and South America.

Under the current administration, Hornbeck lamented, Brazil has not concluded any new or significant trade agreement. Integrating itself with developed economies is the best policy option for Brazil to promote long-term growth—a stated objective of President Luiz Inácio Lula da Silva’s economic policy. He reflected that although the ethanol initiative between Brazil and the United States will not likely produce any economic results, at least it kept “the lines of communications open.”

The Trade Outlook After the 2008 U.S. Election

For Trade Counsel of the House of Representatives Committee on Ways and Means *Jason Kearns*, a Republican or Democratic administration will not make much difference on how the United States approaches its trade policy. For any president to advance the trade agenda, he or she must be willing to question the current system as a whole and come up with a new agenda.

Contrary to political pundits’ belief that the Bush liberal trade agenda will move forward only if a Republican wins the White House in November 2008—stalling under Democratic leadership—Kearns highlighted that, in the last three years, trade agreements have not advanced much under the leadership of either party. The fact that neither party has been able to advance trade legislation through Congress is evidence that the country needs to rethink its stance on trade and how it can move



From left to right, I.M. Destler and Jason Kearns

forward with a new vision. In addition, Kearns was quick to point out that public support for U.S. trade policies is rapidly deteriorating. He referred to a Wall Street Journal/NBC poll taken on October 4, 2007 showing that 59 percent of Republican voters view trade as “bad” for the country, which suggests a “rocky outlook for trade expansion.”

Kearns said Republican Presidential candidate John McCain’s proposal to continue the Bush trade agenda will not help the country change the nation’s new skepticism on trade and cautioned that new advancements in trade can only take place in the context of an overhaul of U.S. trade policies. In his view, there are three options for the next administration to take: “stay the course,” which would result in “near or total deadlock;” to stop altogether; or, to shape a new course, which means learning from the past and remolding trade policies to optimize its benefits. Of the presidential candidates, Sen. Hillary Clinton (D-New York) was the only candidate who came the closest in manifesting her support for a comprehensive review of all Free Trade Agreements (FTA) to better judge what is best for the country, Kearns said.

I.M. Destler, a visiting fellow of Peterson Institute for International Economics, noted that Hillary Clinton's blueprint for trade, outlined in her "Rebuilding the Middle Class" speech, focuses on enforcing barriers in the United States and tearing down barriers in other countries. Clinton has criticized the Bush administration for its poor enforcement record of trade agreements. During the Bush Presidency, the U.S. has enforced the same number of provisional violations that were filed during one year of Bill Clinton's administration. Hillary also called for a thorough five-year review of all free trade agreements and highlighted the need to address displaced workers by expanding their benefits.

Destler pointed out that Bill Clinton finished a global trade deal started by President George H. W. Bush and questioned whether Hillary Clinton, if elected, would follow the same footsteps of her husband and finish what the current administration has begun.

According to Destler, if Doha negotiations reach a successful conclusion, trade may move higher up on the list of priorities. Trade can become a priority if the new administration tries to put in place a "new domestic bargain." He explained that by attaching a range of social policies to trade policies, such as pension reform, tax and labor union recognition and income inequality, policymakers can help pacify the public's skepticism towards trade. In Destler's view, these could be tools to mobilize Democratic support in Congress to a renewed agenda of trade liberalization. For Destler, this is a "good time" for trade liberalization given the status of the economy, the depreciation of the dollar and the healthy trade balance. He said that one of the major issues is the lack of trust among Democrats and Republicans, but added that such trust can be built gradually.

John Huenemann, principal in the International Department of Miller & Chevalier, said it is crucial to examine what is driving, or what can

"TO EXPAND BRAZILIAN-U.S. RELATIONS, BOTH COUNTRIES MUST MOVE BEYOND THE CURRENT FOCUS ON ETHANOL AND INTRODUCE MORE TRADE-RELATED ISSUES TO THE BILATERAL AGENDA."

drive, change in U.S. trade policies. Huenemann questioned whether the new agenda would be dictated by fears, opportunities, realism or naïveté. No presidential candidate has shown any particular insight as to how the U.S. should engage globally—likely because trade is not going to be at the top of the agenda.

Despite their differences, Huenemann said the Brazilian-U.S. trade relationship is at its highest point; even in the absence of a trade agreement, bilateral commerce has grown substantially. U.S. exports to Brazil increased from \$12.3 billion in 2002 to \$19.2 billion in 2006. In that same period, imports of Brazilians goods to the United States grew from \$15.7 billion to \$26.3 billion. But, in order to make greater progress, both governments need to make "courageous political decisions" to move both countries to the next level and change the dynamic of the hemisphere. In the absence of change in the current FTA model, however,

neither country is likely to advance trade much beyond current levels.

More promising results can be achieved if Brazil and the United States are willing to balance out costs and benefits associated with bilateral trade. Huenemann argues that the United States should be willing to cut agricultural subsidies in return for an FTA with Brazil. On the Brazilian end, the country must be willing to change its position on services, market access and intellectual property issues. While in the United States there is mounting political pressure for a comprehensive revision of trade policies, in Brazil, the same political willingness does not appear to be in place. Given the fact the United States only seeks trade agreements outlined according to *its* model, and Brazil's unwillingness to negotiate FTAs based on the U.S. model, future bilateral or hemispheric trade agreements likely will not advance much, at least in the near-term.

Brazil-U.S. Economic Relations: Beyond Ethanol

From a public policy perspective, limiting discussions about Brazilian-U.S. trade relations to just its recently signed ethanol initiative would be shortsighted. *Kellie Meiman*, managing director of McLarty Associates, observed that it is necessary to look beyond the ethanol initiative to properly evaluate present and future trade relations between the two most populous countries in the hemisphere.

Meiman and *Paulo Sotero*, director of the Brazil Institute, pointed out that the foreign direct investment scenario has changed over the years. Historically, American companies were the ones investing in Brazil. Today, Brazilian companies have become investors abroad and are increasing their presence in the United States.



Kellie Meiman

The new two-way street on investment flows between Brazil and the United States has renewed interests and pressures from business in both countries to create a tax treaty, which has been intermittently contemplated by Brasilia and Washington since the 1980s, with no results. Brazil's recent progress in the research, development and production of pharmaceuticals and other products may also lead the country to review and expand its intellectual property protection laws—although the fact that Brazilian companies are seeking more patents outside Brazil indicates the challenges involved in reforming the countries intellectual property system.

The panelists agreed the mounting pressure from the private sector pushing for a more aggressive international integration should serve as a red flag to Lula's defensive policy position. Brazil's ability to expand its trade horizons, however, will not depend on the private sector as much as it will depend on Brasilia's politics.

BRAZIL INSTITUTE

Created in June 2006 as part of the Wilson Center's Latin American Program, the BRAZIL INSTITUTE strives to foster informed dialogue on key issues important to Brazilians and to the Brazilian-U.S. relationship. We work to promote detailed analysis of Brazil's public policy and advance Washington's understanding of contemporary Brazilian developments, mindful of the long history that binds the two most populous democracies in the Americas.

The Institute honors this history and attempts to further bilateral cooperation by promoting informed dialogue between these two diverse and vibrant multiracial societies. Our activities include: convening policy forums to stimulate nonpartisan reflection and debate on critical issues related to Brazil; promoting, sponsoring, and disseminating research; participating in the broader effort to inform Americans about Brazil through lectures and interviews given by its director; appointing leading Brazilian and Brazilianist academics, journalists, and policy makers as Wilson Center Public Policy Scholars; and maintaining a comprehensive website devoted to news, analysis, research, and reference materials on Brazil.

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