Can Brazil Benefit from President Trump's Trade Policy?

EXECUTIVE SUMMARY

Brazil's strength in agribusiness and desire to forge stronger trade relationships around the globe may present to the country the unique opportunity to benefit from the Trump administration's newly proposed trade policies. Actions by the new U.S. president have threatened the future of the Trans-Pacific Partnership (TPP) and other multilateral agreements, and caused tensions with China and Mexico. Brazil may be ideally positioned to fill the potential gap left by the United States by satisfying demand for agricultural exports in Mexico, China and former-TPP nations. Additionally, the hiatus in global trade integration may allow Brazil to "catch-up" to other countries by negotiating new bilateral agreements, including with the United States. Despite predictions of destabilization in the global financial system, the Temer government may find itself better positioned than most to take advantage of a paradigm-shifting moment in global trade.

Speakers

Gary Hufbauer, Reginald Jones Senior Fellow, Peterson Institute for International Economics
João Augusto de Castro Neves, Director, Latin America, Eurasia Group
Diego Bonomo, Executive Manager of Foreign Trade, Brazilian National Confederation of Industry
Marcos Jank, Vice-President, Corporate Affairs and Business Development, BRF Asia-Pacific
Fernando Pimentel, Deputy Chief of Mission, Economic Affairs, Embassy of Brazil to the United States

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Brazil finds itself in a unique position at the start of the new U.S. administration. The world's most closed economy among middle income countries, Brazil is also a rare case of a nation that runs a trade deficit with the United States. While some see President Donald Trump's protectionist trade policy positions as an obstacle to globalization and international trade, many in the Brazilian media hailed the new president's decision to withdraw the United States from the Trans-Pacific Partnership (TPP) as an opportunity for Brazil's commercial sector. The 12-nation trade deal, of which Brazil was not a part, risked cutting Brazilian exports out of certain TPP markets, noted ***Paulo Sotero***, director of the Brazil Institute, as he opened the conversation; however, some in the Temer administration and in the Brazilian business community now believe the deal's uncertain future may open opportunities for trade and investment in South America, Mexico, and Asia. The experts assembled each gave their perspective on the specific nature of this opportunity and what Trump's policies could mean for a Brazil, whose nine-month old government is more willing to negotiate trade than its predecessors.

Gary Hufbauer, Senior Fellow at the Peterson Institute for International Economics, provided insight into the Trump administration's likely direction on trade, emphasizing that it remains a "work in progress." Top trade officials have yet to be confirmed by the Senate and protectionist rhetoric—which has weakened since the election—has not yet produced protectionist policy, leaving "the bark...worse than the bite."

The first major implementation of Trump's trade policies will most likely be a renegotiation of the North American Free Trade Association (NAFTA), where even small changes in the agreement with Canada could lead to a protracted debate in Congress and aggressive rhetoric toward Mexico could signal harsh negotiations aimed at reducing the bilateral trade deficit. In both negotiations, the United States may push for a strong currency provision as well as request that Canada and Mexico take extraordinary measures to reduce a trade surplus with the United States, should one develop.

Hufbauer noted that as the United States seeks to develop further bilateral agreements, it will favor countries with which it has a trade surplus—which is good news for possible U.S.-Brazil bilateral negotiations.

> *"My expectation is that the Trump administration will go forward more quickly with the Obamacare repeal and replace, and tax reform, than [it will] on agressive trade measures. But we will see."*
>
> \- *Gary Hufbauer*

While the future of TPP is uncertain without the United States, there is still hope for the agreement should Japan decide to take the lead on negotiations. As Japan's primary motivator for entering the agreement, however, was access to the U.S. market, their leadership seems unlikely. The outlook for other agreements is varied: the Transatlantic Trade and Investment Partnership (T-TIP) as well as the Trade in Services Agreement (TiSA) will more than likely not go forward, but the Environmental Goods Agreement should proceed despite disagreement between the United States and China. Similarly, the Trade Facilitation Agreement was recently ratified at the World Trade Organization.

Despite the heavy rhetoric on trade during the campaign, Hufbauer predicts that the Trump administration will focus and move more quickly on domestic efforts like healthcare reform, tax reform and infrastructure projects, leaving trade negotiations for further down the road.

Marcos Jank, Vice-President of Corporate Affairs and Business Development at BRF Asia-Pacific, noted that several factors are likely to create opportunities for agribusiness in Brazil in the short run, in particular growing Brazilian and South American exports, an expected sizeable food surplus in Brazil and South America, and prospects of bilateral trade deals with countries such as Mexico and China in the wake of the Trump administration's decision to withdraw from the TPP.

Marcos Jank (left) and Gary Hufbauer (right)

According to Jank, agribusiness has kept Brazil's trade balance positive with a $75 billion surplus compared to a $55 billion deficit in other sectors from 1989 to 2015. In fact, Jank argued, agribusiness is the "only sector where Brazil is a global player," referring to Brazil's traditional tendency toward economic "isolationism." Jank noted that Brazil has the largest agro-food trade surplus globally, while China has the largest deficit. Indeed, Asia in general faces a growing deficit in this area, which is expected to reach $300 billion by 2025, compared to a $250 billion expected surplus in South America. As a result, China has increasingly opened its market to certain imports, including soy and iron ore—products that Brazil exports in large quantities. These two products and their derivatives account for around 80 percent of China's imports from Brazil. Nearly 50 percent of Brazil's agricultural exports and 24 percent of its total food exports currently go to China, and Brazil could see these quantities increase in the coming years.

> *"...there are opportunities in the short term, but the long term is very uncertain."*
>
> *- Marcos Jank*

However, Jank also pointed out that while Brazil has been traditionally worried about protectionism in Europe, the country should be more concerned over the potential effects of rising protectionism in China and Asia, and in the United States under the current administration.

Speaking specifically on Trump administration policies, Jank discussed several possibilities for Brazil. Prospective opportunities include bilateral trade agreements with Japan, South Korea, China, and Mexico, as well as a potential multilateral agreement with TPP countries. He argued that there are considerable opportunities for Brazil if the country could summon the courage to take on the U.S. role in a reworked TPP. Jank also suggested that Brazil could try to replace the United States as the source of corn and meat imports to Mexico should U.S.-Mexican relations deteriorate. Similarly, Brazil could replace U.S. exports to China, if relations between the two economic powers worsen—especially as the United States is Brazil's main agricultural competitor for the Chinese market.

However, Jank noted that if the United States decides to withdraw from the international system it created, the system itself—multilateralism—will be at risk. International organizations including the World Trade Organization, World Bank, International Monetary Fund, and North Atlantic Treaty Organization would face significant challenges in the absence of an engaged United States, and replacing the existing world system with bilateral agreements would be extremely difficult. Considering the potential for entering new markets and the likely reshuffling taking place in the international community, Jank concluded by predicting that there will be opportunities for Brazil in the near future, but overall uncertainty in the long run.

Diego Bonomo, Executive Manager of Foreign Trade for the Brazilian National Confederation of Industry (CNI), stated that, from an industry perspective, there are both positive and negative potential consequences of President Trump's trade policies for Brazil.
According to Bonomo, the positive effects are most likely to come from Brazil's engagement with third-party countries. Brazil stands to benefit if Trump policies increase uncertainty or add costs to U.S. trade and investment with third-party countries where Brazil also has trading relationships. In fact, in recent months Brazil started negotiations with Mexico and the European Free Trade Association (Brazil was already in talks with the European Union), and there is talk of potential agreements with Japan and South Korea as well. Brazil could also benefit from a potential increase in tension between the United States and China, as well as from a souring of U.S.-Iranian relations.

Bonomo noted that the Trump administration's current path could allow Brazil to "catch up" in terms of trade agreements. He described how Brazil moved from pursuing the creation of a hemisphere-wide free trade market from 1985-1995, to attempting (and failing) to expand Mercosur to all of South America from 1996-2005, to losing focus on trade from 2006-2016. Bonomo argued that this third phase is the reason why Brazil currently has access to less than 8 percent of free trade globally. There are therefore many opportunities for new deals, although the figure also reveals how far behind Brazil is compared to many other trading nations.

> *"The country that has the most to lose to Trump is Mexico...Brazil is somewhat shielded. We're not on Trump's radar...As long as Mexico is bad in Latin America, Brazil tends to be on the good side."*
>
> *- João Augusto de Castro Neves*

Yet President Trump's trade policies also bring clear risks for Brazil. First, the border adjustment tax under consideration by the new American administration could affect Brazilian exports to the U.S. market. Second, trade remedies could affect steel, chemical, and other sectors in Brazil. Third, the U.S. Congress has threatened for years to remove Brazil from the Generalized System of Preferences (GSP) list, which eliminates duties on certain products when imported to the United States. Brazil remained on this list because the United States buys inputs from Brazil, but it could be removed in the future. Fourth, Brazil has been negotiating to become part of the U.S. Global Entry program, and to include the United States in Brazil's own global entry program. Pushbacks on immigration will most likely block or at least delay this process.

Bonomo concluded by noting that the new U.S. administration could find an open reception in Brazil—due to the Brazilian government's more conservative, pro-business leanings—if the United States approaches Brazil in a pragmatic, transactional way. The United States remains a top priority for Brazilian businessmen, and continues to be the top target market for Brazilian exporters.

João Augusto de Castro Neves, the Eurasia Group's Latin America Director, discussed the political context of President Trump's trade policies and their effects around the world. He focused initially on global issues, then discussed the effects of policies on Latin America and Brazil.

Castro Neves argued that any changes to U.S. trade policy will be more gradual than most assume. He maintained that Trump's promises should be taken with a "healthy dose of skepticism," not only in regards to trade but also in regards to U.S. isolationism. He acknowledged, however, that the global wave of populism and nationalism, Trump's election, Brexit, and other events around the world, could pose a risk for Brazil's prized Mercosur-EU trade deal, especially with European elections taking place this year.

Castro Neves also insisted that the idea that China will become the new leader of global trade and capitalism is unlikely to come to fruition. China remains an authoritarian country with little transparency. Moreover, the current priority in China is to deal with its domestic political transition, not to replace the United States as a world leader. Nonetheless, Trump's presidency could signal a shift from a multilateral trade landscape to one more focused on bilateral agreements.

In Latin America, according to Castro Neves, the country with the most to lose as a result of Trump's trade policies is Mexico. In Mexico, a Trump presidency encourages a shift to the left, although for the rest of the region it encourages a shift from economic nationalism to a more orthodox economic policy.

Castro Neves stated that there is an important distinction between the "antiestablishment" sentiment in developing and developed countries. For the developed world, the sentiment stems from a declining middle class that feels it is on the losing side of globalization. For the developing world, especially in Latin America

Diego Bonomo (left) and João Agusto de Castro Neves (right)

and Brazil, this antiestablishment sentiment originates instead from a rising middle class. The result of this contrast is a shift toward isolationism in the developed world but a shift toward greater openness in the developing world.

The financial risk for Latin America from Trump's domestic policies includes inflationary pressures and weaker currencies if the U.S. Federal Reserve raises interest rates. Brazil is relatively well-shielded from these effects, considering that trade is a small function of its GDP—and Brazil is not on Trump's radar (especially since the United States runs a trade surplus with Brazil). Castro Neves predicted that as long as President Trump remains focused on Mexico as his adversary in Latin America, Brazil will not be on the administration's radar.

> *"The way we see it, as we try to understand the new government... [is that] it is still too soon to know the shape and the effect of many policies."*
>
> *- Fernando Pimentel*

Domestically, however, Brazil faces problems of its own. Castro Neves summarized President Temer's priorities as being 1) survive until the end of his term, 2) implement a robust and ambitious fiscal adjustment plan, and 3) attract foreign direct investment. Trump may make Temer's second and third goals more difficult to accomplish.

Castro Neves concluded that the shift to bilateralism may provide a "shock therapy" to Brazil's trade policy, arguing that Brazil may finally have a chance to catch up by redrawing agreements with Latin America and other important partners. The Temer administration will pave the way. If the next government deepens some of these changes and the economy grows post-2018, it could generate an even greater willingness to shift to the right and negotiate trade more openly.

Fernando Pimentel, a Deputy Chief of Mission charged with economic affairs at the Brazilian Embassy in the United States, noted that it is hard to predict the consequences of Trump administration policies because the government is quite new and there are many variables involved in the decision-making process. He contended that it is still too soon to quantify whether Brazil will "win" or "lose."

Pimentel agreed that the global trade "reset" caused by the U.S. exit from TPP provides Brazil with an opportunity but cautioned that it also poses is a serious risk to the current rules-based trading system. The World Trade Organization is already deadlocked, and its legitimacy and results are now being challenged. Its trade arm will probably not become less deadlocked, and there's a possibility for an overload of dispute settlements. Nonetheless, only 1.2 percent of Brazil's GDP is related to exports to the United States as opposed to 27 percent in Mexico. As Pimentel concluded, Brazil is currently better positioned than many other countries to withstand the effects of changing U.S. trade policy.

Q&A Session

A dialogue involving the audience—of approximately fifty people—followed the panelists' remarks.

Q: Should Brazil take advantage of the tensions between Mexico and the United States in order to make a bilateral U.S.-Brazil deal? Or should Brazil approach third party countries and take advantage of the opportunities on the table as the United States abandons TPP?

Gary Hufbauer argued that U.S.-Mexico negotiations will likely serve as a test case for other countries interested in bilateral deals with the United States. I If their deal ends up being palatable, Brazil might expect to be able to negotiate a deal. However, the U.S. position could end up being "too hard" to allow for an agreement that other countries would find acceptable.

Marcos Jank said that despite the long term risks, Brazil should explore bilateral negotiations with the United States. According to a survey he conducted, Brazilian agro-food companies primarily want to export to China and other Asian countries, with Europe and finally the United States a distant third and fourth. He also contended that there is still room for Brazil in a deal with TPP countries despite the fact that TPP countries are now looking to China to fill the void left by the United States.

Q: Do we know anything about the conversations between Trump and Temer that might offer insight on a potential free trade agreement between Brazil and the U.S.?

*João Augusto de Castro Neve*s noted that Temer spoke with Trump prior to his inauguration, and that Temer and Vice-President Pence have also spoken—although the conversations were not very specific: they revolved mostly around values, including democracy. Brazil is not on Trump's priority list and the Temer government has less than two years left in office, making a trade deal challenging. This is a longstanding issue in U.S.-Brazil relations, since their elections oscillate every two years.

Diego Bonomo noted that there are opportunities beyond a free trade agreement. Negotiations have begun, but not concluded, on several agreements including include a tax treaty, an investment treaty, a visa agreement, and a seventeen-year-old agreement on satellites. The satellite industry is a $2.5 billion market, of which Brazil currently has no part due to the Brazilian Congress' refusal to vote on a proposed agreement reached at the turn of the century. The Temer administration is very pragmatic, and bilateral talks are already in place, so in theory, his government simply needs to finish negotiations on these agreements. So far, however, Brasília has seemed quiet and the U.S. Embassy in Brasília appears to be waiting for instructions.

Paulo Sotero added that the area of defense is an important one to watch, as Embraer will continue to seek defense contracts with the United States, and American companies such as Boeing and Lockheed Martin will explore opportunities that could emerge from shifting political winds in Brazil.

Q: What will be the consequences for Brazil if the U.S. Congress approves a border adjustment tax?

Diego Bonomo said a border adjustment tax would increase the cost of Brazilian exports, although Gary Hufbauer argued such a tax is very unlikely to be approved by the U.S. Senate. He noted that three Republicans stand against the tax in addition to Democratic opposition. If it does pass, it would be based on a combination of the nominal dollar exchange rate, price levels in the United States, and trade balance with the United States. There is no consensus on what the exact balance between these three elements would be, although few are arguing that it should rely heavily on the nominal exchange rate.

Q: Recently, Mexico said it wants to ban U.S. corn inputs and instead buy corn from Brazil and Argentina. Is this a credible threat? Additionally, will Brazil try to get involved with the upcoming TPP summit in Chile?

Marcos Jank stated that although the TPP is not on current on the Brazilian agenda, it should be. Looking at trade balance, most of Brazil's trade in the Americas is dependent on GSP and is very industrial. There could be opportunities for complementary trade with Japan and other smaller Asian countries through TPP. With regard to Mexico, there are opportunities for Brazil to export more grains and meat. The opportunity to export corn would be especially beneficial.

Luiz Caruso, Brazilian Agricultural Attaché in the United States, noted that Brazil currently has around 6 to 7 percent of the world's agricultural market, and that the Ministry of Agriculture plans to reach 10 percent of the world's share in the medium term. Brazil has been in discussions with other countries in the hopes of gaining new markets, but he affirmed that it is not Brazil's goal to take away markets from the United States. Nonetheless, Brazil and the United States are the two top players across the agricultural sector, so one may benefit when the other loses business. Caruso insisted that Brazil sees itself as a partner of the United States, with significant shared investment, rather than a competitor. If a shift does occur, however, it will be a natural market shift and not a result of deliberate government action.

From left to right: Diego Bonomo, Marcos Jank, Gary Hufbauer, and João Agusto de Castro Neves

Marcos Jank reminded the audience that the United States remains the largest agricultural exporter, followed by Europe, in value-added products, and only then Brazil. Therefore, Brazil needs to start engaging in talks now that there is an opening —especially as the Temer government does not have the ideological opposition to trade that characterized much of the Workers' Party [of former Presidents Luiz Inácio Lula da Silva and Dilma Rousseff].

Q: One of the largest meat producers in the United States is a Brazilian company. Will this have an effect?

Gary Hufbauer stated that if Brazil wants to explore trade relations with the United States, it should do what Switzerland and Japan are doing by advertising the U.S. jobs that would be created as a result
Paulo Sotero noted that there are around 70,000 Americans employed by Brazilian owned companies in the United States, many of them in Colorado.

Q: What are concrete examples of the competition between the U.S., Brazil and China and which products you think will see a rise in cost here because of the immigration policies? Which sectors do you think you could benefit? Is bilateralism a new global trend or rather just a trend in the West but not in Asia?

Marcos Jank asserted that Asia is moving to regional deals, such as the TPP, the Association of Southeast Asian Nations (ASEAN), and Regional Comprehensive Economic Partnership (RCEP). In terms of competition between Brazil and the United States, the first sector is soybeans. Brazil, Argentina, and the United States control the global soybean export market. Meat is another area: China imports most of its meat from Brazil, but the United States is also a competitor. Any escalation of reciprocal trade protectionism between the United States and China would benefit Brazil.

Q: How will tax reforms affect internationalized U.S. companies that rely on traditional U.S. trading partners like Mexico? How do you see this reform going on? How much of a risk is this reform to the Brazilian private sector?

Gary Hufbauer stated that Trump has been unclear so far on what his tax policy will be. Trump has spoken a great deal about implementing some type of border tax, but he will not want to be blamed for higher prices on cheap imported goods. Hufbauer believes President Trump will be able to slash the U.S. corporate tax rate, expense capital equipment, and pass some form of territorial system. These measures will make the United States an extremely attractive place to invest in, which will affect other nations' tax policies. He also added that the border adjustment tax rate is actually less important than the corporate tax rate.

Diego Bonomo asserted that companies in Brazil are concerned, but many of them are already invested in the United States. Although they may be concerned from an export point of view, they may also be interested in tax reforms for their own operations. An important aspect of this relationship is that while exports to China are usually goods that go to end users, exports to the United States are usually in the form of investments or inputs in value chains.

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