

Brazil and Trade Developments

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Competitive liberalization: United States & Brazil

The global trading system is currently in the process of a major transformation, and the rise of Brazil is part of that tectonic shift. Over the past three decades, the international economy has undergone a massive transformation as globalization has connected national economies and economic power has spread from developed to developing countries. The world economy has been transformed due to revolutions in technology, computing, communications, and transport technologies. The rapid integration of world markets has heightened competition not only for goods and services, but also for labor capital, knowledge and ideas. World economic growth has now reached its highest level in 30 years.

A larger trade debate is taking place in Washington on the trade-offs of competitive liberalization of markets in the context of globalization, and the analysis is seemingly grim. Most notable is the U.S. trade deficit with China which has increased from \$57 billion in 1998 to \$233 billion in 2006, although the U.S. unemployment rate in 2006 was a mere 4.6%, and according to the Federal Reserve, U.S. manufacturing output in 2006 was 20% higher than in 1998.¹ China has also reiterated its unwillingness to adjust its undervalued exchange rate even with its capital reserves of \$1.2 trillion now the highest in the world.² These reserves have accumulated largely from China's export performance and have been converted into foreign-exchange reserves to prevent domestic inflation.

The benefits of competitive liberalization for the United States are seen most clearly in capital returns as opposed to labor. Calculated projections that as many as 35-40 million workers may lose their jobs due to outsourcing have heightened concerns of various constituencies across the United States. Into this background of United States' domestic uncertainty steps Brazil – asserting itself in a more active leadership role in the Southern Hemisphere and in the international community, particularly among middle-income countries. Brazil has become an important partner for the United States in the Southern Hemisphere as a robust democracy with shared values of Western civilization. The United States is also Brazil's largest single-country trading partner.

Brazil's status as the 10th largest economic power in the world is remarkable in the context of its highly bureaucratic layers of government, including excessive regulations, ineffective law enforcement, and high tax and interest rates.³ However, the country's stable democratic system with opposition parties that routinely challenge prevailing policies, coupled with Lula's strong macroeconomic policies have made it an attractive market for regional and direct foreign investment, the latter reaching \$31 billion in 2006.⁴ Brazil's economic growth may exceed 4% this year and their exports and trade surplus are at record highs, pushing foreign-exchange reserves above \$100 billion.⁵ Brazil is the world's largest producer of sugar cane, oranges, and coffee, and the second largest of corn, soybean, beef and poultry. It is also a major producer of steel, automobiles, auto parts and aircraft. To support its strong growth in exports, Brazil is taking bold action with a multibillion-dollar initiative to improve the precarious state of its government

¹ "Federal Reserve Statistical Release: Industrial Capacity and Production Utilization," 17 October 2006, 31 May 2007, <http://www.federalreserve.gov/Releases/G17/20061017/g17.pdf>.

² Paul Maidment, "What's Behind the Surprise Rise in China's Forex Reserves," 16 April 2007, 31 May 2007, <http://forbes.com>.

³ "IMF World Economic Outlook: Spillovers and Cycles in Global Economy," April 2007.

⁴ "Net Foreign Direct Investment in Brazil," Central Bank of Brazil, June 2006, 30 May 2007, <http://www.gwu.edu/~ibi/Statistics%20PDF%20Files/Foreign%20Direct%20Investment.pdf>.

⁵ "Land of Promise," *The Economist*, 14 April 2007: 4.

infrastructure. President Lula da Silva's ambitious initiative projects spending approximately \$252 billion over the next four years – \$29 billion on transportation, \$138 billion on energy, and \$85 billion on other infrastructure projects.⁶

Trade Negotiations: DOHA Round and FTAA

The United States continues to press forward in the Southern Hemisphere for competitive liberalization through multilateral, bilateral and regional trade agreements. The WTO's Doha Round, which was initiated in 2001 as a way to facilitate trade negotiations between wealthy and developing nations, lost substantial legitimacy in the international community due to numerous missed deadlines and delays. The Doha Round was revived in 2004 after stalling in September 2003 in Cancun, Mexico when Brazil led the G-20 group of developing countries against the United States to reduce and eliminate agricultural subsidies as part of their final settlement. However, since the Hong Kong Ministerial Conference in December 2005, talks have been indefinitely suspended due to the failure of negotiating groups to reach an agreement on agricultural tariffs and subsidies. Reaching an agreement is important to the United States since it has already established low trade barriers. To continue benefiting from trade, the United States needs similar access to other countries' markets, including Brazil's services and manufacturing markets.

Despite slow progress, member countries have expressed hope for completing the Doha Round by the end of 2007.⁷ President Bush regards the talks as an important step not only in improving the United States' economic position, but also as a way of supporting poor countries' development and in alleviating world poverty, generally.⁸ With the President's Fast Track Negotiating Authority, which allows him to submit legislation to Congress for acceptance or rejection but not amendment, set to expire in July 2007, there is renewed vigor on the part of the United States to expedite Doha trade talks.

The reality is that Brazil has been, and continues to be, a strong competitor of the United States in multilateral trade negotiations. Although the United States and Brazil co-chair the Free Trade Area of the Americas (FTAA) Trade Negotiation Committee, any consensus is unlikely until the framework for a multilateral agreement, (Doha Round), is agreed upon. Given the aforementioned setback of Doha Round negotiations, progress on the FTAA is at an indefinite standstill.⁹ Negotiations on the FTAA reached an impasse due, in part, to regional leaders' rejection of United States free-market policies and imbedded populism in the region which made Mercosur, South America's largest trading bloc, a priority for the Southern Hemisphere. Brazil's reluctance to lend its muscle to the FTAA negotiations is, arguably, due to the fact that Brazil seeks to retain its hegemonic position in the region, which would be undermined if the United States were able to gain greater market access through FTAA.

Brazil's critique of the United States' trade policies are centered on agricultural subsidies which diminish their market access, and their desire to curtail the use of anti-dumping and countervailing duties. Agribusiness, (commodity and processed goods), account for approximately 30% of Brazil's GDP, which explains Brazil's emphasis on reforming the United States' agricultural policies.¹⁰ Brazilian officials argue that the United States' import restrictions on agricultural products, e.g. sugar, soy, peanuts, chocolate and orange juice are not easily put on the table for negotiation.¹¹ The United States' critique of Brazil's trade policies is focused on its need to gain access to foreign manufacturing import and service markets, as well as concerns over Brazil's high tariff structure on industrial goods, and Mercosur's common external tariff program. For an advanced economy like the United States, market access in services – financial, telecommunications, technology – is an essential component if there is to be any progress in the Doha Round. An Innovation Summit is planned for July 2007 between the United States and Brazil to discuss all of these issues.

For Brazil to be in a position to craft mutually beneficial trade agreements with the United States and other potential trading partners, it must first identify and rectify issues within its government. To aid Brazil in its path to increased trade liberalization, critics recommend that their taxation system, legal and judicial processes, and the policies of their central bank be reviewed. In particular, government spending on pensions¹², transfers and bureaucracy

⁶ Andrew Downie, "Brazil: Too many bumps in the roads?" *The Christian Science Monitor*, 23 May 2007, 30 May 2007, <http://www.csmonitor.com/2007/-523>.

⁷ William Schomberg, "Trade Powers Call WTO talks Productive," *The Washington Post*, 18 May 2007.

⁸ Carrie Loewenthal, "U.S., Brazil Seek Balanced Doha Agreement, Bush Says," 1 April 2007, 24 May 2007, <http://usinfo.state.gov>.

⁹ The FTAA was initiated in 1994 by 34 countries in the Western Hemisphere who sought a Free Trade Area of the Americas, but has failed to be formally established.

¹⁰ Joaquim J. M. Guilhoto, "The Regional (State Level) Importance of The Agribusiness GDP in the Brazilian Economy," 31 May 2007, <http://ideas.repec.org/p/anp/en2004/119.html>.

¹¹ In Brazil's economy, services account for 53%, industry and manufacturing for 37%, and agriculture for 9% of GDP.

¹² The ineffective use of monetary funds can be seen in Brazil's pension system which provides 2/3 of recipients, many of whom did not pay into the system, with a normal minimum level salary. A system of transferring money from wealthy Southeastern states to

operations need to be reduced to more modest levels appropriate to a developing country. These issues are representative of the larger problem of an inefficient bureaucracy with high wages for public servants, high tax rates and low rates of investment. For Brazil to successfully participate in multilateral trade agreements, it must develop a more streamlined bureaucracy so that its inefficiencies do not hinder trading relationships.

Mercosur

South America's leading trading bloc, Mercosur, which brings about the free movement of goods, capital, services and people among its member states, currently accounts for more than three-quarters of the economic activity on the continent. Established in 1991 by Argentina, Brazil, Paraguay and Uruguay under the Treaty of Asuncion, the 1994 Treaty of Ouro Preto formalized the customs union as Mercosur.¹³ The tariff policies regulate imports and exports, and the bloc of five members can arbitrate in trade disputes among each other. Critics argue that Mercosur has become politicized, as negotiations to secure a trade agreement with the European Union have been stalled with an impasse on farm subsidies and tariffs on industrial goods. While Brazil and Argentina are Mercosur's economic giants – Bolivia, Chile, Colombia, Ecuador and Peru are associate members and can join free-trade agreements, but do not benefit from the bloc's customs union.

Intellectual Property Protection

At the forefront of trade relations between the United States and Brazil is the ability of the United States to protect intellectual property developed within its borders. It has also become the critical issue for the United States in its negotiating position in multilateral trade agreements. According to the President's Council of Economic Advisors, intellectual property, resulting from the invention, research, design and testing of ideas and products, has a value of more than \$5 trillion.¹⁴ The piracy of United States intellectual property leads to nonpayment of hundreds of millions of dollars annually.

The World Trade Organization's Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement, developed during the Uruguay Round from 1986-1994, establishes a minimum level of protection for intellectual property that member countries must provide to fellow WTO members.¹⁵ Although this agreement represents groundbreaking work to potentially protect intellectual property, many countries still lack the political will to enforce its rules. To help protect itself from piracy, the United States has supplemented the WTO's work by increasing intellectual property protection enforcement and working to further bilateral free trade agreements. The Strategy Targeting Organized Piracy (STOP!) was created as part of the United States Patent and Trademark Office to focus on catching "fakes" and developing policies that the United States can use to improve patent, trademark and copyright protection.¹⁶

Due to the tremendous market potential of Brazil, it is of particular importance to the United States' economy that piracy between Brazil and the United States is reduced. According to the International Intellectual Property Alliance's 2007 Special 301 Report, this process has already begun. Estimated trade losses due to copyright piracy were down from \$957.3 million in 2005 to \$850.8 million in 2006.¹⁷ This success was mainly due to the creation of the National Council to Combat Piracy and Intellectual Property Crimes (CNCP) in March 2005.¹⁸ To further decrease piracy between Brazil and the United States, the Special 301 Report recommends focusing on reducing copyright piracy in both physical markets and through the internet and also by establishing a more effective criminal enforcement system in Brazil.

Of current concern to the United States is the repeated threat by Brazil to break the patents of American pharmaceutical manufacturers' HIV/AIDS drugs, and to produce generic equivalents due to unaffordable pricing. Brazil has also set price controls and freezes on patented drugs which cut deeply into pharmaceutical companies' profits and their R&D departments.

poorer states also leads to inefficiencies since not all states are capable of effectively spending funds on health, education and administrative needs.

¹³ "Profile: Mercosur-Common Market of the South," 30 May 2007, <http://newsvote.bbc.co.uk/mpapps/>.

¹⁴ "Stronger Enforcement, Better Intellectual Property Rules," *Investor's Business Daily*, 27 April, 2007, 25 May 2007, <http://usinfo.state.gov>.

¹⁵ "Overview: The Trips Agreement," 23 May 2007, http://www.wto.org/english/tratop_e/trips_e/intel2_e.htm.

¹⁶ "International IP Advisory Program," 1 June 2007, <http://www.stopfakes.gov/>.

¹⁷ International Intellectual Property Alliance, "2007 'Special 301' Recommendations, Appendix A: 2005 and 2006 Estimated Trade Losses Due to Copyright Piracy," 12 February, 2007.

¹⁸ "International Intellectual Property Alliance: 2007 Special 301 Report, Brazil," International Intellectual Property Alliance, 12 February, 2007: 210.

Ethanol

It now appears that achieving President Bush's goal of replacing 75% of Middle Eastern oil imports with domestically produced ethanol by 2025 could be facilitated with collaboration between the United States and Brazil.¹⁹ Brazil replaced the United States in 2006 as the largest producer of ethanol. As such, it is an important ally in the United States' mission to promote global energy security and environmentally responsible practices. The United States and Brazil account for over 70% of the world's ethanol production, but with almost half of its domestic passenger vehicle fuel needs satisfied by ethanol, Brazil is setting the precedent for economically and environmentally responsible fuel use. Despite a temporary decrease in demand for ethanol fueled cars when oil prices fell in the 1990s, 77% of new cars in Brazil currently run on ethanol.²⁰ Brazil's "fuel-flex" cars, introduced in 2003, run on ethanol, gas, or any combination of the two, allowing consumers to select the most efficient combination depending upon market prices.²¹

In addition to the established infrastructure for ethanol use and distribution, Brazil has a strong advantage in ethanol production due to the low costs associated with sugar cane-based manufacturing. In comparison to the United States' corn-based production which costs about 30 cents per liter, Brazilian sugar cane-based ethanol production at 22 cents per liter, is more efficient.²² This is one factor which led the United States to establish a 54 cent tariff on most imported ethanol.²³ In March 2007, the United States and Brazil signed a memorandum of understanding agreement to advance biofuels cooperation. This agreement established mutual cooperation in reducing production costs, improving land use demands and increasing global awareness of biofuels through the promotion of biofuel production in Central America and the Caribbean, and by developing fixed biofuel purity standards throughout the global community in conjunction with the International Biofuels Forum (IBF).²⁴ The agreement seeks not only to improve biofuel technology, but also to emphasize a long-term strategy to promote energy security in the Western hemisphere.

Conclusion

In sum, whereas the United States' trade strategy emphasizes the negotiation of comprehensive trade agreements on multiple fronts, Brazil is focused on market access in those industries in which they can secure economic dominance in the Southern Hemisphere. Brazil focuses on agricultural priorities on all trade fronts whether in the WTO-Doha Round, expanding Mercosur membership, or reluctance on the FTAA if their primary interests are not realized. Despite different approaches to trade policy, both countries recognize the potential for mutually beneficial gains from trade liberalization at the multilateral or regional levels. Toward this end, both the United States and Brazil have constructed a productive trade relationship in pursuit of maximizing gains in their national interests.

¹⁹ Alan Clendenning, "Brazil is World's Ethanol Superpower," 13 March, 2006, 25 May 2007, <http://www.cbsnews.com>.

²⁰ Almeida, Rodrigo, "Brazil, the United States and Ethanol," 30 March, 2007, 25 May 2007, <http://www.opendemocracy.com>.

²¹ Alan Clendenning, "Brazil is World's Ethanol Superpower," 13 March, 2006, 25 May 2007, <http://www.cbsnews.com>.

²² Almeida, Rodrigo, "Brazil, the United States and Ethanol," 30 March, 2007, 25 May 2007, <http://www.opendemocracy.com>.

²³ Reel, Monte, "U.S. Seeks Partnership with Brazil on Ethanol," *The Washington Post*, 8 February, 2007.

²⁴ "Memorandum of Understanding between the United States and Brazil to Advance Cooperation on Biofuels," 9 March 2007, 25 May 2007, <http://www.state.gov>.