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Working Paper

Brazil-US economic relations and the enterprise for the Americas Initiative

Texto para discussão, No. 296

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Suggested Citation: de Paiva Abreu, Marcelo (1993) : Brazil-US economic relations and the enterprise for the Americas Initiative, Texto para discussão, No. 296, Pontifícia Universidade Católica do Rio de Janeiro (PUC-Rio), Departamento de Economia, Rio de Janeiro

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DEPARTAMENTO DE ECONOMIA

PUC-RIO

TEXTO PARA DISCUSSÃO
N.º 296

**BRAZIL-US ECONOMIC RELATIONS AND THE ENTERPRISE
FOR THE AMERICAS INITIATIVE**

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JANEIRO 1993

Brazil-US Economic Relations and the Enterprise
for the Americas Initiative

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Table of Contents

1. Brazil-US Economic Relations in the 1980s
 - 1.1 The background
 - 1.2 The deterioration of Brazil-US bilateral relations in the 1980s
 - 1.3 Frictions in the GATT
 2. The Impact of Domestic Economic Reform on Brazil-US Relations
 - 2.1 Domestic economic reform
 - 2.2 The reduction of Brazil-US economic frictions
 3. New Directions in Economic Integration in Latin America
 - 3.1 The North America Free Trade Area
 - 3.2 The Enterprise for the Americas Initiative
 - 3.3 Regional integration: the heterogeneity of interests
 - 3.4 The timing and scope of future economic integration
 4. US-Brazil Relations and Regional Integration in the Americas
- References

This paper, which is mainly concerned with trade relations, is divided into four sections. In the first section the context in which Brazil-US economic relations sharply deteriorated in the 1980s is examined both bilaterally and in relevant multilateral fora such as the GATT. The second section considers how economic reform, specially trade reform, as well as the adoption of a more positive approach to multilateral trade negotiations in the GATT, reduced these frictions as from 1988. The third section assesses alternative implementation scenarios for bloc formation initiatives, involving Latin American countries and the United States and Canada, such as the North American Free Trade Area and the Enterprise for the Americas Initiative (EAI). Likely impacts on Brazil are evaluated. The final section considers how the increased importance of regional integration is likely to affect Brazil-U.S. relations bilaterally and in multilateral fora such as the GATT.

1. Brazil-US Economic Relations in the 1980s

1.1 The background

The objective of this section is to consider the impact of the economic crisis of the 1980s on Brazil-US relations and in particular the significant deterioration in bilateral and multilateral economic relations affecting trade matters.

There were several significant irritants inherited from the late 1960s and 1970s². The policy of close political alignment with the US which prevailed in the period immediately after the 1964 coup led to a reversal of stances in international fora such as in the cases the reservations placed on some of the principles included in the Final Act of the UNCTAD Geneva Conference of 1964 or the cooperation of Brazilian troops in the intervention in the Dominican Republic.

After 1967 the Brazilian stance has started to change. In the negotiations leading to Treaty for the Prohibition of Nuclear Weapons in Latin America signed at Tlatelolco, Mexico in 1967 Brazil did not waive the requirement of full ratification as a precondition for effectiveness. The Nuclear Non-Proliferation Treaty of 1968 was also not signed. National security interests served as rationale for the maturing of policies which tended to increasingly reassert Brazil's autonomy in relation to the US.

In the trade arena the Brazilian position also began to shift. In the UNCTAD meeting at New Delhi in 1968 Brazil withdrew its reservations of 1964 and took an active part in the negotiations which led to the introduction of Generalized System of Preferences by all developed countries in spite of the marked US reluctance to do so.

²Lima (1986) is a standard treatment of Brazil-US relations in the context of nuclear energy and trade.

The sharp rise of oil prices after 1973 tended to reinforce rather than defuse latent or overt bilateral frictions given Brazil's dependence on imported oil. In the nuclear field Brazil signed in 1975 with the Federal Republic of Germany an Agreement Concerning Cooperation in the Field of the Peaceful Use of Nuclear Energy which involved the construction of nuclear power stations and the transfer of sensitive technology in the fields of uranium enrichment as well as of production and reprocessing of nuclear fuels. This move marked a merge of economic - that is prospectively energy saving - arguments with those of a more political character which underlined the usefulness of the agreement from a political point of view and specially so in connection with the bilateral relations with the US.

Indeed the Carter administration abandoned the previous administration's emphasis on Brazil-US relations since Brazil was an emerging regional power center. Not only it strongly reacted against the Brazil-Germany Nuclear Agreement but also applied pressures in relation to the Brazilian human rights record during the Geisel administration. Resulting frictions resulted in the denunciation of the long-standing agreement on military cooperation.

In relation to trade Brazil adopted an increasingly aggressive stance in its bilateral relations in the Middle East and Africa trying to assure long term oil supply and to use oil purchases as a lever to increase exports through countertrade deals.

Since these deals entailed a mushrooming of military equipment exports it is not surprising that the coalition backing these new policies gained considerable strength. Partly because of oil considerations but also as a natural backlash, given its formerly stand in favor of Portugal in its colonial conflicts in Africa, Brazil adopted a position of high profile specially in Southern Africa, reasserting the independence of its foreign policy in relation to the US.

In the field of high-technology goods and intellectual property there was also a build up of potential friction as Brazilian policy targeted strategic sectors such as electronics and pharmaceuticals as those which would most benefit from government support given their key role in assuring a self sustained endogenous development of required technologies. The establishment of absolute protection to domestic production of microcomputers is only one example of such policies. Domestic support was assured by a blend of lobbies based on a mix of concerns on national security, sovereignty or appropriation of scarcity rents.

Brazil was not very active in the GATT before the Tokyo Round. Towards the end of the Round, however, in the negotiations of both the so called Framework group and of the GATT codes Brazil had a more active role³.

³See Abreu (1992) for Brazil's role in the Tokyo Round.

The negotiations in the so called Framework group⁴ originated from a Brazilian proposal which included among other subjects the provision of a legal basis for GSP which would entail the consolidation of preferences and establish liability to compensation in the event they were withdrawn and more flexibility in the use of article XVIII for balance of payments purposes⁵. Negotiations resulted in the consolidation of the derogation which legalized non reciprocity based in special and differential treatment⁶.

The US dissatisfied with what was seen as consistent free riding by developing countries US emphasized the importance of negotiating specific codes which attempted to limit MFN treatment to signatories. The code on subsidies was the most important code from the point of view of Brazilian interests to be negotiated in the Tokyo Round. For code signatories the application of compensatory duties should be based on proof of injury to domestic industries. The reluctance of Brazilian negotiators from the Ministry of Foreign Affairs yielded to US pressures through the Brazilian Ministry of Finance and Brazil agreed to the gradual removal of tax credits tied to export performance as well as to freeze the level of export

4 From The Legal Framework for Differential and More Favourable Treatment for Developing Countries in Relation to GATT Provisions.

5 See Maciel (1978) and Winham (1986), pp. 144-146. The original document, which incorporates Brazilian proposals is entitled Statement by the Representative of Brazil, H.E. Ambassador George A. Maciel, 21 February 1977, GATT MTN/FR/W/1, of the same date.

6 See Winham (1986), p.274 ss.

subsidies⁷. Brazil was the first developing country to sign the code on subsidies. Other developing countries which followed as signatories made less significant concessions as is clear in the vague undertakings entered by India and Pakistan⁸.

1.2 The deterioration of Brazil-US bilateral relations in the 1980s

The marked deterioration in Brazil-US economic relations in the 1980s had both financial and commercial manifestations. In the financial field, however, frictions were generally of a more diffuse nature, either frequently involving the intermediation of the International Monetary Fund and the World Bank, or also affecting commercial banks other than those from the US. The main exception was an incident involving a link between financial and trade matters. Brazil's financial vulnerability in the end of 1982 led to a sudden weakening of its bargaining position as, when the need for a US Treasury bridge loan was most pressing, the US government successfully exerted considerable pressure to make Brazil agree to soften its stance of resisting the inclusion of the so called "new themes" in the GATT Ministerial Declaration. Skirmishes of bilateral inspiration may also have contributed to make relatively more abrasive than they would have been Brazilian relations with international financial agencies, notably the World Bank.

7 See Lima (1986), pp. 330-336.

8 See Hufbauer (1983), pp. 341-2 and Winham (1986), pp. 222-3.

In 1987 US-Brazil financial relations probably reached their lowest point since the early 1960s as Brazil declared a foreign debt moratorium. Its repetition in 1989 was less abrasive as it was clear that some of the political constraints to a normalization of the debt position could be removed by the first free Presidential election in 29 years and some trade liberalization was already occurring.

Difficulties related to commercial issues, both bilateral and multilateral, were much more explicit and permanent. The imposition of anti dumping and subsidy countervailing duties was much more actively used by the US in the 1980s than in the past and affected Brazilian exports quite significantly. In several instances Brazil faced US actions or was considered as a target for US actions under Section 301, "Super 301" and "Special 301" of the Trade Act of 1974.

It is notoriously difficult to assess the protection implications of anti dumping as well as subsidy countervailing duty actions due to their dissuasion impact. Compared to other countries which are not developed (developing and centrally planned economies), Brazil has been an important target for AD initiations in the US in 1982-86 and less so in 1988-90, reflecting overall incidence of such actions. Other affected countries in this group were China, Taiwan, South Korea and South Africa. Brazil has also faced many CVD actions mainly between 1982 and 1986: in three of

these years it led (or co-led the league of affected countries). . . Other importantly affected countries besides those also mentioned in relation to AD actions were Mexico and Venezuela.

AD and CVD actions have affected Brazilian exports such as airplanes, iron ore pellets, iron and steel products, paper products, plywood, tools, cotton yarn, leather apparel, chemical products such as ethyl alcohol, fatty acids, oxalic acid and cyanuric chloride, petrochemical products, orange juice, castor oil products, rifles, paint filters, brass sheets and strips, crankshafts, steel wheels, shock absorbers, electromechanical counters, silicon metal and footwear⁹.

Brazilian steel and iron exports to the US have been affected by VERs from 1984 to early 1992. Similarly, Brazilian exports of textiles and clothing are constrained by export limitations negotiated bilaterally under the Multifibre Arrangement umbrella.

Brazil was less affected by AD and CVD actions in the second half of the 1980s at least in part because of the use of other protectionist instruments. Thus Brazil has faced US actions under Sections 301 of the Trade Act of 1974, as amended, "Super 301" and

9 For a complete list of actions between 1979 and 1990 see the annexes of Destler (1992) as well as, for earlier actions, IPEA/CEPAL (1985).

"Special 301". Of 87 of such initiations between 1975 and October 1991, 6 were against Brazil (other developing countries affected included the Republic of Korea which faced 8 initiations, Taiwan and Argentina 5 and India and China 4)¹⁰. Brazil was the only developing country to suffer retaliation from the US under 301 as in October 1988 action was taken by the US imposing tariffs of 100% on Brazilian paper, pharmaceutical and electronic products entering the US market. This resulted from a complaint by the Pharmaceutical Manufacturers Association that the Brazilian intellectual property legislation did not provide adequate protection for US pharmaceutical patents.

The other important 301 case affecting Brazil was related to the informatics policy, in particular software legislation. The case was initiated by the USTR in 1985 based on grievances concerning access to the Brazilian software market, protection of intellectual property in relation to software and hardware and administrative procedures adopted by the Brazilian authorities in the informatics sector. It was only terminated in October 1989 after changes in the relevant Brazilian policies. Brazil was designated in May 1989 as one of the priority countries for application of retaliation under 301 in relation to the Brazilian import licensing system.

10 See GATT (1992), p. 127 and GATT (1989), pp. 260-65. Initiations against Brazil affected footwear, informatics products, soybean oil and meals, import licensing and patenting of pharmaceutical products and processes.

1.3 Frictions in the GATT

Deterioration in Brazil-US relations also resulted from different stances adopted in multilateral fora and specially so in the GATT. On the one hand, there was a natural process of multilateralization of some of these bilateral disputes as some of them were naturally raised in the GATT. On the other, there was much scope for difference of stands between the two countries in relation to the new round of multilateral trade negotiations.

There were in the 1980s many instances of consultations and panels of Brazilian interest in the GATT, both as a complainant (the Brazil-Spain 1980 panel on the tariff treatment of unroasted coffee, the consultations held in 1982 on the EC sugar export refund system in which Brazil was one of the ten countries involved, the 1986 Brazil-US consultations on US tariff on ethyl alcohol, the protracted Brazil-US dispute on CVD duties charged on non rubber footwear, the 1988 Brazil-US consultations on the unfavorable impact of US subsidies under the Export Enhancement Program on Brazilian exports of soya bean oil) and as a defendant (the US 1983 complaint on Brazilian violation of Code of Subsidies in relation to poultry exports, the US-Brazil 1987 aborted consultations on restrictions on micro electronic products and the US 1989 complaint on the Brazilian

quantitative import control regulations)¹¹.

But by very far the most significant issue of Brazilian bilateral interest to be discussed in GATT in the 1980s was related to retaliatory action already mentioned in the previous subsection taken by the US in 1988 by imposing tariffs of 100% on selected Brazilian paper, pharmaceutical and electronic products entering the US market. It was perhaps the most extreme demonstration of how far the US Administration was willing to go in its policy of keeping pressure on Brazil to improve access to the Brazilian market as well as to assure enforcement of stricter intellectual property legislation. Brazil asked for the establishment of a panel to consider the questions of principle involved in the American action. The US foot dragged but the a panel was eventually established early in 1990. There was no agreement on its terms of reference as the US insisted that the substantive Brazilian legislation should be examined while Brazil centered its case on the conflict between the American action and GATT rights and obligations. Terms of reference limited the panel to examination of compatibility of action with GATT. The US faced much criticism of their action in the GATT as its action was not preceded by any effort to settle the dispute using GATT machinery.

Moreover, in the strictly multilateral scene there was

11 This and the following paragraph are from Abreu (1991). For data see GATT, GATT Activities, several issues as well as GATT (1989) and (1992).

continuous friction between the two countries during the period which preceded the launching of the Uruguay Round as a small group of developing countries, in which Brazil played a key role, and the US disagreed about the inclusion of the "new themes" (trade related investment measures, intellectual property and services) in its agenda. This was naturally feared by these developing countries to be likely to undermine their emphasis on unfinished business remaining from previous rounds of negotiations. It was also thought that it was unlikely that in such themes it would be possible to reach agreements which would result in roughly equivalent concessions following GATT traditional negotiation procedures¹².

With the inclusion for all purposes of the "new themes" in the Uruguay Round negotiations agenda in Punta del Este (two tracks and all), and partly due to internal developments, Brazilian policy after 1987 started to move towards a more active role as a demandeur. It was fortunate that Brazil had a credible, and naturally available, fall back position as an initial, but far from enthusiastic, member of the Cairns group of fair (and not so fair) traders in agricultural temperate products. From 1987-88 Brazil started to play an increasingly important role in agricultural

12 For the evolution of Brazilian stance in the GATT see Abreu (1992). For countries without much bargaining power it became increasingly clear that it would be impossible to try to apply the equivalence of concessions rule. It became increasingly common to justify the advantages of liberalization based on standard efficiency grounds for "small countries". It is, however, less common to find acknowledgement that efficiency rules do not necessarily apply to contracting parties with negotiating clout.

negotiations as well as in other negotiating groups. As agricultural negotiations became the main apparent stumbling block to progress in the round Brazil played an important role, in Montreal, in the GATT Mid Term Review in December 1988, in assuring support for the stand by the Latin American members of Cairns, then of the Cairns group, endorsed by the US, of conditioning results in all negotiating groups to progress in agricultural liberalization.

2. The Impact of Domestic Economic Reform on Brazil-US Relations

2.1 Domestic economic reform

Domestic reform since 1990 played an extremely important role in drastically reducing bilateral Brazil-US frictions. Prompted by a mixture of disappointment with the performance of the economy, deepening of the fiscal crisis, wear and tear of interventionist policies and, perhaps to a smaller extent, by international pressure, the Brazilian policy of export promotion and import repression had already slowly started to change in 1987. In 1987-89 the list of products affected by de facto import prohibitions was progressively reduced, other non tariff barriers removed and tariff rates reduced. The level of tariff protection remained quite substantial and non-tariff barriers formidable. Average nominal tariff was in the region of 35% at the end of 1989 (maximum rate 85%) and effective rates of protection were mostly between 30 and

60% but reached extreme values of more than 150% (transport equipment).

It was from March 1990, when the new government took office, that a significant shift in economic policy took place. New policies were designed (some of them with a considerable delay) and implemented on price stabilization, foreign debt renegotiation and structural reform. Almost from the start, however, the new administration stand on many issues was marred by its clear ambiguity between reform and the continued adoption of long established corrupt practices. It was difficult to be at the same time against legal rent-seeking behavior and engage in, or condone, straightforward corrupt practices.

The failure of successive price stabilization policies in curbing inflation, the basic government objective, has perhaps tended to obscure concrete achievements in relation to the other economic objectives such as debt renegotiation and structural reforms. Whether these achievements can be sustained with the deterioration in the political situation which led to the impeachment of President Collor remains to be seen.

Since early 1991 much progress has been made in relation to the foreign debt renegotiation. Successive agreements were reached with the IMF on macro economic adjustment in January 1992, with the

Club of Paris on foreign official credits in March 1992 and with the private banks in July 1992. The continuation of program with the Fund would now require not only redefinition of targets but also the approval of a significant fiscal package before the end of 1992. The clear reluctance by the Franco administration to consider as politically acceptable the continuation of economic recession required by a new stabilization program is an indication of the persistent difficulties ahead. In spite of these gloomy perspectives it is likely that agreements with both the Paris Club and private creditors go ahead.

In these conditions it has proved difficult to attract foreign capital (or foreign currency deposits held by Brazilians abroad) on a permanent basis in spite of a significant increase in capital inflows prompted by the very high interest rates adopted to avoid hyperinflation.

The program of structural reforms introduced by the Collor administration included elements of privatization, deregulation and trade liberalization. Privatization has proceeded somewhat slowly due to law suits against privatization, constitutional restrictions of privatization in sectors such as oil exploration, refining and transportation, and the emphasis on a transparent market-oriented process. It is indeed remarkable that the process has been free from accusations of corruption in spite of wide differences of opinion on

its conception and implementation, in particular concerning the almost exclusive use of several types of heavily discounted government paper. The privatization program has been quite successful if account is taken of constraints. Usiminas, the largest Brazilian steel mill (output of 4 million tons/year), and Copesul, an important petrochemical upstream plant (sold for US\$ 1.3 billion) were the most important privatization cases. Foreign capital, however, has not shown interest in the privatization effort, an indication of lack of confidence in policy decision-making and implementation in relation to price stabilization.

Deregulation affecting domestic activity in practice mostly affected the pricing of inputs such as steel and fuels in past subject to the distortions of strictly enforced national prices. Foreign trade deregulation was significant but is treated below under trade liberalization. There is much to be done in this area but it is unlikely that Congress approves sufficiently liberal legislation on relevant issues. Surely the most important of these is the deregulation of labor supply arrangements in ports as well as increased competition in the use of port facilities.

Trade liberalization included the elimination of prohibition in the import licensing process and of almost all non-tariff barriers, the reformulation of the system of export incentives and the introduction of a multi-year tariff reduction program which

would reduce average tariff rates from 32% (maximum rate 105%) to 14.2% by October 1993 (maximum rate 35%). Bureaucratic requirements affecting imports and exports were reduced. State monopolies in the trade of wheat, coffee and sugar were discontinued as well as the main state trading company. The list of imports and exports requiring prior approval of government departments was drastically reduced. Non Tariff protection affecting electronic products was also abolished.

There is scope for further liberalization mainly in relation to national content requirements which discriminate between domestic and foreign products or products generally in relation to access to official credits or to public procurement. The relaxation of restrictions on the right of establishment of foreign firms in certain sectors, specially in services, provides much scope for efficiency improvement.

In spite of many recent statements to the contrary by the government there are solid grounds to doubt that trade liberalization can proceed unhindered as it seems to lack effective political support. Powerful industrialist and trade union lobbies have started to voice their opposition to the approved tariff reduction schedule. The possibility of a reversal of the liberalization trend cannot be dismissed.

2.2 The reduction of Brazil-US economic frictions

The elimination of frictions with the US generated by trade relations bilaterally and multilaterally was a consequence of the shift towards liberalization. The removal of import licensing extinguished the basic reason for Brazil's designation as a priority target under "Super 301". Similarly, undertakings by the Brazilian government to propose intellectual property legislation which should considerably improve protection and allow process patenting made possible the removal of "retaliatory" tariff rates by the US and eventually the withdrawal by Brazil of complaints in the GATT. These changes were still being considered by the Brazilian Congress. Changes in the legislation concerning informatics answered to a large extent US complaints in the sector.

The shift in US trade policy towards a more liberal Brazil was also expressed by the reversal of a long standing US policy concerning graduation of products enjoying preferential treatment under GSP as preferences were restored in 1990 for products whose trade covered about US\$ 0.5 billion.

AD and CVD actions became less frequent for a while but the end, in early 1992, of the arrangements which limited the supply of

Brazilian steel products in the US market led, as would be expected, to a number of anti dumping initiations.

In the GATT, not only multilateral frictions originating from bilateral difficulties were removed, but also Brazil tended to take a more active stance in actual negotiations, including on the "new themes". In the meeting at Geneva which should end the Uruguay Round Brazil's played again an important role in the coalition which refused to proceed without a commitment by the EC and other protectionist countries in temperate agriculture to liberalize more significantly their policies. When, after one year of stalemate the GATT Secretariat, presented a final act draft embodying the result of negotiations since 1986, Brazil was one of the contracting parties which, in spite of its reservations to certain parts of the draft, indicated its willingness to accept it.

More recently, minor problems emerged in the GATT. The old Brazil-US dispute on CVDs on non-rubber footwear Brazilian exports has flared up as Brazil has blocked, with support of other contracting parties, the adoption of the panel's report in favor of the US. Similarly, the US blocked, at least temporarily, Brazil's somewhat odd attempt to obtain GATT's approval of its Mercosul arrangements under the Tokyo Round Framework agreement - which assures developing countries special and differentiated treatment - rather than under the theoretically more exacting, but notoriously

laxly applied, Article XXIV. In mid-October 1992 Brazilian policy was for the first time assessed under GATT's Trade Policy Review Mechanism with quite a Favourable outcome.

3. New Directions in Economic Integration in Latin America

This section considers economic integration encompassing Latin American economies and the US and examines proposals and alternative implementation scenarios from the viewpoint of Brazilian interests. Relevant initiatives include mainly the North American Free Trade Area (NAFTA), incorporating Mexico to the Canada-US Trade Agreement (CUSTA), and the Western Hemisphere Free Trade Area (WHFTA), as a possible outcome of Enterprise for the Americas Initiative. The Mercosul initiative will be taken into account in what follows to the extent that it constrains or fosters economic integration involving Brazil and the US.

Regional economic integration has been hailed by many as a strategy more likely to further trade liberalization than multilateral trade negotiations conducted in the GATT. It is however not easy to show the unqualified inherent economic advantages of taking regional economic integration as a road leading to a global market unhindered by obstacles to the free flow of goods, services

and factors¹³. Such advantages are likely to vary substantially depending on characteristics of different economies. Arguments based on political expediency to show the advantages of regionalization over globalization seem much more effective and are, of course, much helped by the lack of results in the GATT negotiations. Other frequent arguments used to underline the advantages of regional integration stress that FTAs assure access to markets which would otherwise further restricted and lock in liberalization commitments protecting them from revision in the future. One feels that the advantages of locking in liberalization provided by GATT tariff bindings, specially in the case of small economies, have been somewhat disregarded.

Mancur Olson has suggested the application of the theory of collective action to explain why a small number of countries interested in regional integration, with more apparent sectoral interests, are more likely to succeed than a large number of countries aiming at the successful conclusion of multilateral trade negotiations in relation to which benefits are more widely spread. This view perhaps underestimates the importance of differences in size and/or bargaining power among GATT's contracting parties. The theory of collective action is certainly is relevant to explain the present deadlock in the GATT which is essentially explained by the

13 See on this Lawrence (1991) and, specially, Bhagwati (1992) who stresses the conflicts between regionalism and multilateralism. See also Lawrence (1991) and Fishlow and Haggard for views more inclined to see the advantages of regionalism.

EC objections to the extent and pace of agricultural liberalization¹⁴.

In sharp contrast with the 1960s recent integration initiatives involving Latin American economies include as an explicit end to increase access to the US markets. This is has become possible as the levels of tariff and non tariff protection have dramatically decreased in the last decade. As it is clear that NAFTA takes precedence over WHFTA in the US agenda it seems more useful to consider first NAFTA and its implications then its docking provisions and compatibility with WHFTA or with other regional integration arrangements which do not include the US such as Mercosul.

3.1 The North America Free Trade Area

Irrespective of the result of the American Presidential elections the NAFTA Agreement is unlikely to be substantially affected by US afterthoughts on environmental or labor standards clauses. Election results may be more important to define the most likely US policy concerning the extension of NAFTA.

The NAFTA Agreement is extremely complex, with many direct and indirect implications for Brazilian interests. In relation to trade in goods NAFTA provides for the progressive elimination of all

14 See CEPR Bulletin, 50-51, April/June 1992, p. 18.

tariffs. In most cases tariffs will be phased out immediately or in annual stages over a period of 5 to 10 years. For specially sensitive products this will be extended to 15 years.

It is important to analyze different scenarios concerning NAFTA particularly in relation to the treatment accorded to access of products most affected by US protectionism and likely to be of special Brazilian interest such as sugar, orange juice and certain manufactures.

One of the most restrictive features of the agreement on trade in automotive goods is the high specified level of North American content (62.5%) required to qualify to preferential treatment. Similarly trade in textiles and apparel requires North American triple transformation, or "yarn forward" rules of origin.

Liberalization of trade in agriculture will take in certain cases up to 15 years. Mexico and the US agreed to eliminate all non tariff barriers to their agricultural trade through conversion to tariff-rate quotas (TRQs) or tariffs. Up to the quota threshold trade will be duty free; duties applied to trade exceeding quota limits will be phased out in 10 to 15 years. Sugar and orange juice are the most important products in the US market to qualify for special treatment. Sugar TRQs will be applied in the sixth year

after NAFTA takes effect¹⁵. After 15 years all restrictions on sugar trade will have been abolished except certain US provisions on sugar re-exports. To increase its quota Mexico will have either to increase productivity or shift to the use of corn-based sweeteners in its substantial soft drink industry so as to release sugar for export. Special agricultural safeguards can be applied during the first 10 years.

While some Latin American economies depend very importantly on North American markets - Mexico (more than 70%)¹⁶, Venezuela (around 55%) and Colombia (around 45%) - those are less important for Brazil (less than 30%) and Argentina. These other large Latin American economies depend on European markets (25-30%) as well as on markets in Eastern Europe and other developing economies (especially Argentina). Import commodity structures, on the other hand, to a large extent define the origin of imports. So oil dependent economies such as Brazil purchase a lower proportion of its imports in developed countries and a larger share in West Asia. In 1991 less than 20% of total Brazilian exports were purchased by the US while US imports corresponded to 23.6% of the Brazilian market.

Table 1 presents 1989 shares of Brazil, Mexico, other developing American countries and other suppliers in total US imports of products which are of relevance for Brazil. Products

15 Brazilian 1992 sugar quota in 1992 is of 169,084 tons, that is about US\$ 75 million of exports.

16 1988 data unless stated otherwise.

included in the list correspond to more than 79% of total Brazilian exports to the US in 1991. With the exception of iron and aluminum ores, pulp and waste paper, gasoline, and, to a certain extent, footwear, whose exports in 1989 were of US\$ 2,070 million in 1989 - 23% of Brazilian exports to the US - in most other products there is competition between Brazil, and Mexico for the US market. Other Latin America and Caribbean countries also compete with Brazilian products for the US market but their exports of orange juice, pulp and waste paper, and all manufactures with the exception of electrical machinery, clothing, footwear and scientific equipment to the US are insignificant so that 44% of Brazilian exports to the US does not compete with those from Latin American and Caribbean countries other than Mexico.

[Table 1 here]

Among the largest Latin American countries Brazil was in 1986 the most affected by tariffs and by both tariffs and nontariff barriers in the US. Incidence of all NTBs was marginally lower on imports from Brazil than on those from Argentina and Mexico, but Brazilian exports were relatively more affected by hard core NTBs (quantitative restrictions and flexible import fees)¹⁷. Tariffs are generally low (below 5%) except in the case of tobacco, copper and tin manufactures where they varied between 10 and 17%. Some of the

17 See Erzan and Yeats (1992b), tables 5 and 7.

most important Brazilian exports to the US, however, face significant nontariff barriers: orange juice (excise), sugar (quota), steel products (VERs in the past, now CVD actions), textiles and clothing (under the MFA).

Estimates of static trade diversion caused by NAFTA suggest that total trade diverted would be only about US\$ 441 million of which US\$ no more than US\$ 35 million originating in Latin America. Brazil would be by far the largest loser in Latin America with diverted exports of US\$ 18.3 million of which roughly half of food and agricultural exports and half of manufactures. Trade diversion would be thus dwarfed by the expected income effects of NAFTA generated by a comprehensive liberalization program which goes much beyond trade in goods liberalization¹⁸. Trade diversion of Brazilian exports is zero for many products either because tariff rates in the US are zero or Mexican exports to the US do not exist. This is the case of crustaceans, nuts, coffee, pulp and waste paper, iron and aluminum ores, rubber products and gasoline. Most of trade diversion affects orange juice since Brazil is the dominant supplier of the US and protection is high in the US. But even then trade creation due to NAFTA is small as Mexico is not an important exporter to the US; trade diversion is thus also quite small.

18 Erzan and Yeats (1992b), box 1. Assessment of NAFTA trade diversion affecting Brazilian products is in line with findings on Kreinin-Finger "export similarity measures" of pairs of developing Latin American countries which placed the Brazil-Mexico pair in the top position, that is as the pair of countries with the most similar export structure to the US, see Erzan and Yeats (1992a), box 3.

For most products, however, the potential trade diversion of NAFTA is likely to be far more significant than the static one. Preferential tariff treatment in the US shall stimulate investment in Mexico both by US and other countries' producers of goods now protected by barriers to trade in the US. Incentives to new investment would be relatively more important in sectors relatively more protected. The main products of Brazilian interest which in principle could be substantially diverted, but not before a time lag of 5 or more years, are orange juice, steel products, sugar and textiles. In most cases Mexico will have difficulty in raising present productivity standards to levels required to substantially increase its market shares in the US. It is unlikely that footwear exports are substantially diverted as levels of protection are low with tariffs around 5% and no recent NTBs.

3.2 The Enterprise for the Americas Initiative

In June 1990 President Bush announced the Enterprise for the Americas Initiative based on three pillars: trade integration in a free trade arrangement, foreign investment promotion and foreign debt reduction. Potentially the trade integration proposals are likely to be more significant than those on investment and debt. Liberalization of foreign investment regimes is to be fostered through two IDB-administered programs: a limited technical assistance program and the constitution of a multilateral investment fund. The reduction in debt service is unlikely to provide significant relief,

specially so in the case of Brazil: the Overseas Development Council estimated in US\$ 287 million the likely debt service relief over 1991-1994. It is difficult to see Japan, and especially the EC, enthusiastically cooperating in the provision of additional funds to an initiative which is clearly a counterbalance to their initiatives in the respective areas of main economic influence. The trade element of the Initiative has in any case been clearly dominant as the NAFTA negotiations have successfully proceeded.

Negotiations of FTAs with Latin American countries other than Mexico have been kept at bay until agreement was reached on NAFTA. Under the Initiative for the Americas framework agreements have been signed with many countries and groups of countries. The Rose Garden agreement of May 1991 was signed with the four members of Mercosul. These agreements are quite general and considered as first steps in the negotiation of issues of relevance between signatories.

Although the possibility of a "hub and spoke" model of integration involving the US and Latin American economies the success of NAFTA negotiations suggests as more likely that docking to NAFTA may become in due course the standard way for a Latin American country to achieve economic integration with the US. As the entry of new members erode formerly established preferences it is to be expected that negotiations of new accessions, specially of larger applicants with a productive similar to Mexico's, will face some Mexican resistance.

Estimates of the impact of the preferential removal of trade barriers in the US market on exports of Latin American countries suggest that export gains are heavily concentrated in Mexico and Brazil. Of a total export expansion of US\$ 3,208 million, US\$ 1,640 million would benefit Mexico and US\$ 947 million Brazil. In fact the 14.2% expansion of Brazilian exports is higher than the 9.6% estimated expansion of Mexican exports because energy products - which enter practically duty free in the US - have an important share of total Mexican exports to the US. Total Latin American exports would increase 8% while exports from countries such as Chile, Peru, Bolivia and Ecuador would be less than 3% higher. These estimates refer to exclusive FTAs of each Latin American country with the US; they would not be significantly altered in a scenario where all Latin American countries were integrated to the US but not between them¹⁹.

19 See Erzan and Yeats (1992b), table 8. There no available estimates of the impact of liberalization among Latin American countries on trade flows.

Incentives to integrate, however, may have little relation with static trade gains. Integration with the US may be seen as the best insurance against new trade restrictions in the US or a form to bind the results of trade reform or part of a partly political package to attract foreign investment.

3.3 Regional integration: the heterogeneity of interests

Concrete interest in the proposals for economic integration with the US varies very considerably with the different structural characteristics of specific Latin American economies. Other factors may outweigh the advantages of improved access to the US market. This is the case of Brazil which is, among the larger Latin American economies, the least likely to be enthusiastic about integration with the US in spite of the fact that, as already mentioned, it would be, after Mexico, the Latin American country to benefit most from an FTA with the US in terms of export expansion.

Brazil benefits with a FTA with the US are relatively important because of the value of its exports to the US, because tariffs and NTBs significantly affects its exports to the US and price elasticities of demand for its exports are high.

Brazilian gains are limited by the diversification of its export markets since the share of exports to the US is lower than in most other Latin American countries. Exports to the US has been

losing importance since the record year of 1984 when the US market regained the importance of the early 1970s (see Table 2). From 1984 to 1990 Brazil lost more than one third of its share of the US market. The collapse seems to have been particularly sharp since 1990. In 1991 US exports were less than 20% of total exports.

[Table 2 here]

Disaggregated ratios of Brazilian to total imports (see Table 3) indicate that it was essentially the relative decline of food product exports and to a lesser extent manufactures excluding machinery which explains the decreasing overall importance of Brazilian exports in the US market.

[Table 3 here]

An FTA with the US would have consequences on Brazilian imports and domestic production of competitive products similar to those entailed by a multilateral liberalization. Since the Brazilian tariff is high and given the diversification in the origin of imports, trade diversion of other suppliers would be considerable. It is to be expected that suppliers such as the EC could start, in retaliation, to increase difficulties of access of Brazilian exports. It is moreover likely that relatively inefficiently produced imports from the US would divert efficient producers if no other developed country has preferential access to the Brazilian market. Trade creation in Brazil would also be

relatively more important with a high tariff and thus adjustment costs related to the displacement of domestic producers by imports are likely to be high as the tariff is still comparatively high²⁰.

The importance of the Brazilian market cannot be underestimated even if Brazil's mediocre macro economic performance combining high inflation and fall in GDP per capita since the early 1980s painfully contrasts with the improvement of economic conditions in other Latin American economies such as Chile, Mexico and Argentina.

Brazil is a relatively closed economy partly because but it is so large in comparison with other Latin American economies and it is of continental size. Even so its import market compared to those of other Latin American economies is second in importance only to Mexico's (see Table 4 below) in which in any case the US market share is already very high. From the viewpoint of the US as a supplier assessment of the size of the Brazilian market needs to be somewhat qualified by the importance of fuels in the import bill. Even if, say, Chile's import/GNP ratio is 5 times the Brazilian import/GNP ratio, the sheer size of the Brazilian GNP, about 15 times higher than the Chilean GNP, makes the Brazilian import market about three times the size of the Chilean market. Moreover, the size of the domestic market is increasingly relevant even with relatively low ratios of openness as issues directly or indirectly related to

20 See Fritsch (1989).

foreign investment, such as services and intellectual property, tend to become more relevant if compared to traditional trade issues.

[Table 4 here]

Remaining outside either a "hub and spoke" trade integration of the Americas, or of a WHFTA with many members, or without a preferential arrangement when most other Latin American countries have one, would foster potential trade conflicts with the US. Brazilian exports are likely to be diverted by the US in Latin America given the high share of manufactures in exports to other Latin American countries and the share of Latin American exports in total exports. Only Mexico and Venezuela would be relatively immune to such trade diversion as the share of their intraregional trade in total exports is much below those typical of other Latin American countries.

3.4 The timing and scope of future economic integration

Alternative scenarios on the timing and scope of economic integration of course depend crucially on what is going to be US policy after NAFTA is concluded. One alternative, still more likely under a Democrat Administration is that while NAFTA is being digested, that is while the initial dislocations produced by trade liberalization are faced politically, the US would not be keen to

consider further integration concrete initiatives with a relatively big Latin American economy, either through bilateral FTAs or actual use of NAFTA docking provisions. This will be so in spite of the significant advantages to be gained by the US if its products benefit from preferential access to the Brazilian market. An additional independent deterrent to the US is a continuation of the "sick man of Latin America" syndrome in Brazil as the Franco government in any foreseeable constitutional format proves like its predecessors to create the political conditions required by price stabilization and a return to economic growth.

Moreover, given the similarities of economic structures in Brazil and Mexico, as already mentioned, it is to be expected that Mexico will tend to resist to Brazil-US preferential trade arrangements as previous benefits gained in the US would be eroded. Integration sequencing is likely to be to some extent defined by the resistance to widening integration by previously integrated partners.

The alternative scenario is determined by the US willingness to concretely go ahead with WHFTA because its political significance and perceived economic gains outweigh difficulties caused by domestic unemployment. Attention would tend naturally center on Brazil. Brazil will then face difficult problems. Its interests are clearly multilateral and systemic and not strictly regional. To

proceed with integration with the US would further strain the domestic sectors which are already adjusting to a significant trade liberalization program. Tariff rates, however, are, and will remain after the last round of reductions in mid-1993, above those in other Latin American countries. Trade diversion will significantly affect other suppliers with a risk of retaliation in the case of some of them, the EC in particular. Brazilian ties with in the Mercosul would be strained as Argentina's already considerable enthusiasm with integration with the US is likely to be enhanced. Brazilian efforts to proceed in relation to the Initiative for the Americas on a "4+1", that is Mercosul and the US, basis, rather than bilaterally is likely to be undermined.

Enhancement of intrasectoral trade related to regional integration depend to a great extent on actual timing of inclusion of the bigger partners. So, the later is the integration of, say, Brazil and Argentina to the US in relation to Mexico's, the more likely is that inter and intrafirm arrangements consolidate intrasectoral trade. This affects present industrial capacity and future investment fostered by tariff reductions and improvement in operating conditions.

The stiff rules of origin requirements defined for the automotive industry under NAFTA will contribute to further limit the already limited attraction of investment in Mexico for Japanese

firms. Brazilian capacity to offer an alternative location to such firms is not great due to the present unfavorable macroeconomics conditions. Recent significant capital inflows into Brazil have been mainly attracted by the extremely high real domestic interest rates.

4. US-Brazil Relations and Regional Integration in the Americas

It is not easy to determine how future US-Brazil relations would probably be affected by the most likely outcomes concerning regional integration and multilateral liberalization. Two scenarios based on different US policies on the pace of regional integration have been considered in section 3.4. The first scenario, of US unwillingness to proceed very rapidly with its trade integration with other Latin American economies, would generate less frictions than the second scenario as Brazil would be unenthusiastic in relation to a rapid integration given its diversified interests.

But different trends concerning economic policy and structural reform in Brazil are of paramount importance to analyze the future of Brazil-US economic relations. There is no new fact after President Franco took office which would support any optimism on the ability of the government to reduce inflation as a precondition to a return to growth. Quite on the contrary, everything points out to a return of policies which had seemed doomed such as those subsidizing middle class housing.

On the other hand, it is not unlikely that trade liberalization is frozen or even reversed in special cases. Other structural reforms such as privatization have already been adversely affected. One extremely serious, but frequently missed, consequence the institutional crisis which led to President Collor's impeachment for corruption is that structural reforms introduced by the previous administration are being wrongly associated, specially by vested interests, with the impeached President as being somehow undesirable.

In such a climate there is no credible role for strategic trade policies either as decision-making would face all difficulties of the past, marked by so many incorrect decisions on targeting and pace, with a sharply deteriorated administrative capacity generated by the dismantlement of the Federal administration since the early 1980s. It is unlikely whether the timid advances of political transparency would compensate these unfavorable trends.

If this scenario prevails Brazil's credibility will be continue to suffer with its economic fragility and relations with the US are likely to deteriorate both bilaterally and in multilateral fora.

Given the limits of Brazil's interest in economic integration its stance and activities in multilateral trade in particular in the GATT are likely to be remain of paramount importance in the future. There is scope for convergence of interests with the US in this context.

Brazil priority negotiating agenda in the GATT consists of issues of major interest both from an active and a more passive role. Among the first, in relation to which Brazil is mainly a demandeur, should be mentioned: agriculture; tropical products; textile and clothing; anti dumping, subsidies, safeguards and other impediments which limit exports of manufactures; improvement of the GATT system, definition of rules and their implementation, improvement of dispute settlement. Interests in relation to which Brazil is not a demandeur include new issues which have become traditional such as services, TRIPS and TRIMS. It also includes emerging questions which will tend to become increasingly important in multilateral negotiations in general directly or indirectly concerning the harmonization of policies directly or indirectly related to environmental protection standards, competition, and labor rights as well as to discrimination of third countries entailed by regional integration initiatives such as stringent rules of origin. There is concern in Brazil that Brazil may become a preferred target of discriminatory actions by developed countries, including the US, based in the idea that comprehensive policy harmonization is required to assure a level playing field.

There is a convergence of interests of Brazil and the US in relation to agricultural liberalization and most systemic issues²¹. In relation to most other backlog issues the two countries are likely to have more difficulty in finding common ground as Brazil is basically interested in improving access to the markets of developed countries, including the US. In relation to the "new issues", and, still more, of the emerging issues related to policy harmonization, the potential for friction is considerable since the position of Brazil and the US is reversed as it is the US that leads the group of demandeur countries.

Durable minimization of frictions between Brazil and the US requires a combination of relatively slow hemispheric integration, a continuous commitment to liberalization by both countries in the GATT, and developments in Brazil which would assure the achievement of price stabilization and structural reforms going much further towards a market economy.

21 The asymmetric interests concerning the new issues, particularly TRIPS, combined with certain features of the Multilateral Trade Organization proposed in the Dunkel draft, such as the integrated dispute settlement system allowing cross retaliation, could be unfavorable to countries. Similarly the existence of several specialized councils may weaken the protests of contracting parties with limited bargaining power.

Table 1
United States: Origin of Imports by STIC or groups of products, 1989 (%)

	Brazil	Mexico	Other developing countries in the Americas	Other suppliers	Total imports (US\$ 1,000)
036 Crustaceans	3.61	13.13	29.01	54.25	2,511,091
057.7 Nuts	26.15	5.2	5.36	62.77	312,383
059.1 Orange juice	86.41	10.23	2.86	0.50	569,529
061 Sugar	4.36	5.43	47.79	42.42	891,136
071 Coffee	19.81	19.90	40.84	19.45	2,577,408
12 Tobacco	14.81	2.74	12.06	70.40	799,072
251 Pulp and waste paper	7.39	0.26	0.30	92.04	3,164,367
281 Iron ores	19.21	0	21.78	59.01	608,859
285 Aluminium ores	4.63	0	18.01	77.36	1,708,535
334 Motor gasoline	9.61	0.92	31.87	57.59	5,641,958
62 Rubber	2.93	2.61	0.59	93.87	3,815,576
65 Textiles	3.21	2.89	3.01	90.88	6,416,502
657.5 Cordage	31.44	9.77	4.58	54.20	151,163
67 Iron and steel manuf.	5.85	2.77	2.93	88.45	11,376,408
682 Copper manuf.	3.46	9.13	22.71	64.70	2,238,669
687 Tin manuf.	27.30	5.12	15.66	51.92	343,785
71 Power gen. machin.	4.16	8.38	0.13	87.33	14,488,108
72 Special ind. machin.	1.73	1.13	0.08	97.06	13,390,418
73 Metalworking mach.	0.50	0.20	0.05	99.26	4,004,817
74 Gen. ind. machin.	1.66	4.86	0.20	93.28	14,973,973
75 Office machines	0.18	2.96	0.09	96.78	26,251,716
76 Telecom.	0.05	11.33	0.08	88.54	23,603,881
77 Elec. machinery	0.54	12.75	0.87	85.85	33,033,977
78 Road vehicles	0.92	3.26	0.08	95.74	73,842,585
79 Other transp. mach.	2.79	0.63	0.12	96.46	7,217,377
84 Clothing & acess.	0.69	2.29	8.79	88.23	26,025,982
85 Footwear	12.46	1.95	2.27	83.31	8,795,664
87 Scientific equipment	0.22	7.90	1.31	90.57	5,964,037
88 Photo & optical equ..	1.80	1.60	0.08	96.52	5,997,122

Table 2

 Brazil: Exports to the US, 1980-1990

	Share of exports to the US in total exports (%)	Brazilian share of US imports (%)	Brazilian share of US non-oil imports (%)
1980	17.4	1.61	2.30
1984	28.4	2.38	2.93
1989	24.3	1.82	2.06
1990	24.5	1.66	1.88

Sources: Computed from IMF and Brazilian Central Bank data.

Table 3

 United States: Share of Imports Originating from Brazil in Total
 Imports, 1980-1989, %

	Share in Brazilian exports to the US (1984)	Shares of Imports in the US		
		1980	1984	1989
All food (SITC 0+1+22+4)	31.2	10.73	10.90	6.19
Agricultural raw materials (2-(22+27+28))	1.9	2.79	2.91	3.80
Fuels (3)	9.7	0.06	1.27	0.36
Ores and metals (27+28+68)	5.3	1.51	3.52	3.27
Manufactures (5+6+7+8-68)	49.5	1.04	1.36	1.24
Chemical products (5)	5.5	1.49	3.16	1.57
Other manufact. prods. (6+8-68)	30.5	1.52	1.91	1.57
Machinery (7)	13.6	0.67	0.91	1.05
Memo:				
Iron and steel products	--	2.80	5.04	5.85
Textiles	--	3.45	3.79	3.21
Fruit juices	--	38.78	75.25	55.87

 Source: Computed from United Nations, Commodity Trade Statistics,
 1989.

Table 4

Openness and Size of the Largest Latin American Economies, 1990				

	Exports/GNP	Imports/GNP	Total trade/GNP	Total GDP Brazil=100

Argentina	.138	.046	.184	22.2
Brazil	.078	.056	.134	100
Chile	.335	.274	.609	6.4
Colombia	.166	.137	.303	10.1
Mexico	.124	.131	.255	53.3
Peru	.130	.128	.259	6.2
Venezuela	.341	.126	.468	12.5

Source: computed from World Bank data.

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