BRAZIL'S STRATEGY FOR TRADE
LIBERALIZATION AND ECONOMIC INTEGRATION
IN THE WESTERN HEMISPHERE

by Pedro da Motta Veiga
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FOREWORD

In early 1995, the Inter-American Dialogue initiated a multi-year project, directed by Sidney Weintraub and Ana Julia Jatar, to examine the different trade strategies followed by the countries of Latin America and the Caribbean and to review the integration efforts of the main subregional trading groups. Our purpose was to determine whether Latin America was converging on a clear path toward hemispheric free trade arrangements or if, instead, there were conflicting national and subregional strategies which would interfere with such progress.

Ten papers were prepared for an Inter-American Dialogue conference in Washington late last year that focused on these themes. Studies explored the prospective role of subregional trade pacts in the process of hemispheric economic integration agreed to at the December 1994 Summit of the Americas in Miami. They assessed the current status of the pacts, their likely future evolution, and the policy differences of the member countries. In addition, six country studies discussed the trade strategies being considered by the governments of Latin America’s largest economies. They also analyzed the different forces competing within the countries to set the trade agenda, and the political strength of the various alternatives.

We are pleased to share this country study of Brazil by Pedro da Motta Veiga with you. Given the size of Brazil’s economy and its leadership in hemispheric commercial relations, we believe this is an important paper. It is a preview of the political and economic debates that policymakers will face as they seek to achieve a consensus within the hemisphere.

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Peter Hakim
President
INTRODUCTION

Two key factors explain Brazil’s strategy for Western Hemisphere trade liberalization and economic integration. One is that Brazilian policymakers and opinion leaders believe their nation’s regional trade strategy must be subservient to an overall multilateral approach to managing international economic relations. This study starts with an examination of the implications of this belief. The second factor is the impact of Brazil’s unilateral program of trade liberalization, begun in 1990, on the country’s hemispheric trade policy. The paper explores the recent developments in that program, including the protectionist measures adopted by the Brazilian government last year.

Finally, the paper reviews Brazil’s policy toward hemispheric integration concluding with a reflection on the alternative paths to hemispheric integration, and emphasizing the eventual need for negotiations between the two major subregional trade groups—Mercosur and NAFTA—headed by Brazil and the United States respectively.

BRAZIL: BEYOND THE MULTILATERAL AGENDA?

Brazilian regional integration strategies are shaped by the belief—broadly held in the country’s political and economic circles—that Brazil should favor a multilateral approach because of its global economic interests. There is no question about Brazil’s status as a global trader: 20 percent of the country’s trade is with North America, 27 percent with the European Union, 22 percent with Latin American countries, and 18 percent with the Asia-Pacific region. Foreign direct investment (FDI) flows to Brazil similarly show the diversified nature of the country’s economic interests. Between 1970 and 1992, 34 percent of FDI flows came from North America, 36 percent from Western Europe, and 14 percent from Japan.

In international trade and investment negotiations, Brazilian policymakers are convinced that the nation’s interests are best defended by improving the multilateral trading system and pursuing the “global” agenda of the World Trade Organization (WTO).

Brazilian officials tend to be uneasy with agreements that impose stricter disciplines than current multilateral guidelines. They believe such accords generate higher domestic adjustment costs than those associated with bringing the country’s laws into conformity with multilateral rules. Since Brazil’s trade is spread around the globe rather than focused in the Western Hemisphere, they argue that the benefits to Brazil of regional integration would not compensate for those adjustment costs.

But multilateralism alone is insufficient to protect Brazil’s economic interests. Brazil must also address the issues related to trade and integration in the Americas. The first of these is the spread of subregional free trade pacts in the Western Hemisphere. This began with the proliferation of subregional or bilateral trade agreements in Latin America and the signing of the U.S.-Canada Free Trade Agreement in 1988. The North American Free

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Trade Agreement (NAFTA) brought the two processes together, and gave them a hemisphere-wide potential. As a result, Brazil now faces a new challenge: whether for the first time to consider negotiating commercial agreements with trading partners that enjoy much higher levels of income and productivity.

The negotiation of subregional and bilateral trade agreements throughout the Americas has created a network of preferential tariffs and investment rules that alter competitive conditions for products and companies depending on their origin and the market they target. So far, Brazil has responded to this challenge defensively. It has somewhat adjusted the priority given to a multilateral approach by adopting a specific negotiating strategy toward Western Hemisphere countries, as is examined in detail below. The strategy, however, is directed only at minimizing the potential cost of exclusion from the hemispheric trade initiatives, i.e. to avoid losing export markets or reducing the country’s ability to attract FDI.

The second hemispheric issue is that Brazilian exports are vulnerable to trade and investment diversion caused by the web of preferential agreements. One source of that vulnerability is the high percentage of manufactured goods that are contained in Brazilian exports to the rest of the hemisphere. That percentage is greatest for Brazil’s trade with Latin American countries (88 percent), and is higher for sales to the NAFTA countries than for sales to Europe or Japan. This means that Brazil’s export performance will depend on its manufacturers’ access to regional markets in the Americas.

The high concentration of intra-industry sales in Brazil’s trade mix with countries in the hemisphere also increases the country’s vulnerability to trade and investment diversion. Over 80 percent of Brazil’s intra-industry trade was accounted for by trade with the United States and Latin America. As numerous studies have shown, such trade provides an important spur for the positive, dynamic effects associated with economic integration, such as productivity gains from increased economies of scale and specialization.

It is precisely the strong presence of manufacturing and intra-industry sales in Brazil’s regional trade composition that has forced Brazil to adopt a negotiating approach specific to the Western Hemisphere. Yet Brazil continues to give first priority to multilateralism rather than preferential trade agreements in the hemisphere. The country is particularly uneasy about the prospect of “asymmetrical” negotiations with economically more advanced trading partners such as the United States and Canada.

**Unilateral Trade Liberalization in Brazil, 1990-1995**

With the initiation in 1990 of a gradual, yet far-reaching program of unilateral trade liberalization, Brazil abandoned the closed economic model which it had long followed. Sectoral negotiations were replaced by a comprehensive schedule of tariff eliminations between Brazil and its Common Market (Mercosur) partners. The rules of this subregional integration process came to be patterned after the model of “open regionalism” being advocated and implemented elsewhere in the hemisphere. The decision to liberalize unilaterally also ushered in a new Brazilian strategy toward the General Agreement on Tariffs and Trade (GATT) talks, as Brazil shifted from a reactive and defensive approach to a policy that stressed the country’s commitment to multilateral rules and agreements.

Brazil’s liberalization program removed most non-tariff barriers and lowered the country’s average tariff from 32 percent in 1990 to 14 percent in 1993. Brazil’s effort, however, differed from the trade reforms undertaken by other Latin American countries. Trade liberalization in Brazil was only one element of a comprehensive industrial policy adopted by the Collor Administration in 1990. That policy included: gradual implementation of trade reforms; the continuation of a wide range of tariffs, including tariffs protecting Brazilian consumer durables and some capital goods; an undervalued real exchange rate; and slow growth between 1991 and 1993. It is important to recognize that these other aspects of Collor’s industrial policy kept imports from rising and, at least until mid-1994, dampened the pro-competitive effects that the trade opening could have provided.

The tariff structure that emerged from the 1990 trade reforms marked a transition from Brazil’s inherited protectionist policies toward an economy that encourages competition. The declining protection explains in part why the private sector initially resisted trade reform (even though imports grew only 55 percent between 1989 and 1993).
Twelve hundred leading Brazilian companies expressed support for the country’s trade liberalization program in a survey conducted last year by the National Confederation of Industry. But the partial nature of the trade reforms, which promised yet never fully delivered, increased competition from abroad and allowed Brazilian firms to adjust to the new competitive environment under privileged conditions. Imports grew only gradually, while exports expanded rapidly in response to the consolidation of Mercosur, increased growth in the main Latin American countries, as well as a favorable exchange-rate policy.

Typically, some domestic industries are lost to foreign competition when trade barriers are lowered. As uncompetitive firms lose ground in their home market, they drastically cut back output, and many are ultimately driven out of business. Several industries perished this way during Argentina’s economic opening, for example. Yet this has hardly ever occurred in Brazil, even when the Brazilian government avoided responses to isolated pleas for protection, in part because Brazil’s trade policy institutions were too disorganized. Moreover, Brazil lacked effective antidumping and ant subsidy provisions.

In fact, Brazilian industry was a major beneficiary of the high inflation that existed during the trade opening from 1990 through the first half of 1994. As Brazilian firms cut their costs in response to the trade opening, their productivity rose by an average of nearly nine percent per year between 1990 and 1994. Productivity gains allowed the most competitive sectors to lower prices without squeezing profit margins. And those sectors which enjoyed protection boosted their profits considerably because they were able to raise prices in a domestic market newly freed from price controls.

The Real Plan of July 1994 altered the situation radically. The government began to use industry’s exposure to foreign competition to help control inflation. The trade opening became an explicit part of the country’s macroeconomic stabilization program (Guimarães, 1995). In the following months, the government reduced tariffs in anticipation of the Mercosur’s Common External Tariff (CET). It also cut specific tariffs in response to price increases or shortages, and allowed the exchange rate to appreciate sharply. As these trade barriers fell, imports soared to meet an expanding domestic demand.

Between July and October 1994, imports grew five percent a month, double the pace registered during the previous two years. In particular, imports of automobiles and consumer goods surged, jumping 236 percent and 110 percent respectively between June 1994 and February 1995. Imports of capital goods and raw materials rose less sharply, by 53 percent and 58 percent respectively, during the same period.

At the end of 1994, imports still seemed to pose no real threat to Brazilian industry because “the expansion of internal demand was strong enough to accommodate the growth in both imports and domestic production,” (Guimarães, 1995). Brazilian firms also enjoyed impressive productivity gains, especially in traditionally protected sectors such as the electrical, transport materials, and mechanical goods industries.

The risk of using import competition to fight inflation became evident in the November 1994 trade figures, when the monthly trade balance swung from surplus to deficit for the first time in recent history. This surprised Brazilian policymakers, who thought that the effects of their new strategy would be felt first by small scale firms rather than by the economy as a whole.

The onset of the financial crisis in Mexico in December 1994 cast doubt on the sustainability of macroeconomic stabilization. The Cardoso Administration responded by allowing greater flexibility of the nominal exchange within preset “bands,” and by imposing import quotas on automobiles and some consumer durables. These measures failed to reverse the trade imbalance, however, as high growth rates persisted (10 percent for GNP and 15 percent for industrial production) which produced continually rising monthly trade deficits during the first quarter of 1995.

As a consequence, the government tightened the money supply and reduced credit, leading to higher interest rates and declining consumption. It also raised tariffs on consumer durables and on some consumer non-durables, such as shoes, textiles and apparel. This angered the Mercosur partners because it breached the CET agreement (Common External Tariff) and other recently negotiated trade liberalization rules.

These trade restrictions were a response to the growing demands from industries which suddenly felt threatened by import competition in a constrained
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These trade restrictions were a response to the growing demands from industries which suddenly felt threatened by import competition in a constrained
domestic market. The opportunity for Brazilian firms to make productivity improvements had by this time narrowed dramatically. Also, potential gains were jeopardized by a contracting domestic market, while exports were slowed by the exchange rate appreciation. Moreover, competition from imports kept Brazilian firms from responding to declining sales by increasing prices as they had done during times of high inflation.

The new situation led to the questions that were posed by Ana Julia Jatar in a recent paper (Jatar, 1995): Do the recent policy changes signal a reversal of the trade opening in Brazil? And, if they do, what is the likelihood that a policy retreat regarding open trade might “contaminate” other Brazilian efforts at economic reform?

The latter question can be easily answered. The significant reforms in other areas continue unabated, and recent trade policy measures are unlikely to cause any reversal of these reforms. The privatization program retains its priorities; a new “concessions” law opens public service sectors to private capital; constitutional reforms have ended the state’s oil and telecommunications monopolies; and foreign companies in Brazil now enjoy national treatment. Brazil’s reform program, however, continues to be shaped by certain national measures favoring domestic industry and emphasizing economic growth.

The first question—regarding Brazil’s sustained commitment to a trade opening—requires a more cautious response. Protectionist trade policies have often emerged in Brazil during periods of low economic growth and intense political difficulty. This kind of economic and political climate leads to private sector demands which the government comes under great pressure to accept.

This does not, however, necessarily mean a reversal of trade liberalization in Brazil. The new measures may be only temporary—responding both to the fallout from the Mexican peso crisis and to the perceived need for some political accommodation in the wake of the deep tariff cuts of the previous five years. Moreover, the peso crisis put pressure on Brazil’s foreign exchange reserves as well as on individual firms. And the automatic liberalization process propelled by the Mercosur agreement was undertaken with virtually no antidumping and countervailing duty actions, or sector-specific resistance.

Yet, it may be too early to reach any definite conclusions about the recent trade policy shifts. The government’s capacity to resist demands for protection is only now being tested. Until June 1994, the gradual trade liberalization program did not distinguish between sectors that were internationally competitive and those that were not. It merely gave advantages to firms that modernized and improved their productivity. Only with the rapid rise of imports, beginning in late 1994, did entire uncompetitive sectors, not just individual companies, begin to suffer declining performance and profitability—and feel pressure to become more efficient and internationally competitive.

Despite the portrayal of recent trade measures as temporary exceptions to—rather than permanent retreats from—free-trade principles, caution is justified. As the government responds in ad hoc fashion to domestic demands for protection, its use of trade restrictions may proliferate. This danger will remain until the government better understands how to manage the different international codes negotiated in the Uruguay Round, and it builds an institutional framework to assist or help convert those sectors hardest hit by foreign competition.

In the meantime, the Brazilian government will likely move slowly toward further trade liberalization while it finds ways to compensate different industries for the effects of an appreciating exchange rate. For Brazilian firms facing competition in their home market, this may take the form of new import barriers (against toys, textiles and apparel, for example). For Brazilian exporters, it may mean renewed export subsidy programs, exemptions from federal and state taxes, and intensified efforts to reduce the so-called “Brazil cost” of doing business (reducing port and transportation costs, for instance).

But the government can also reduce the “Brazil cost” by liberalizing regulations governing the highly protected areas of services and investment. A first step in this regard was the implementation of the “concessions” law, allowing foreign and domestic private companies to manage public utilities such as water, energy, sanitation and transportation.

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1 For example, the government should not indiscriminately apply protectionist measures, whether they be WTO-consistent measures or the use of antidumping actions, to address matters that might be more appropriately handled under the WTO Safeguards Code.
In addition, the government may seek new flows of foreign investment by cutting tariffs on imported inputs and raw materials, while maintaining tariffs or other barriers on imports of competing finished goods. These measures are apparently being taken, for example, in the auto sector.

The government’s abandonment of the unambiguous trade liberalization that prevailed between 1990 and 1994 reflects a shift in economic priorities. The Cardoso Administration has given top priority to achieving macroeconomic stability and securing Congressional approval for major constitutional reforms. The administrative focus on those areas will be evident in the government’s trade and industrial policies over the next few years, and this will help to create the political and economic environment required to attain these goals.

The Brazilian Strategy for Western Hemisphere Integration

Brazil’s defensive attitude toward subregional and bilateral free trade in the hemisphere reflects the country’s preference for multilateral trade arrangements as well as some specific features of its trade liberalization program.

Despite certain reservations, Brazil decided to promote Mercosur and its automatic, comprehensive liberalization of trade in goods. That decision can be explained by the country’s unilateral 1990 trade reforms. The reforms transformed subregional integration into a political priority for Brazil, allowing policymakers to make a clean break with the traditional Latin American pattern of trade negotiations based on selective sectoral concessions. Yet Brazilian policymakers and corporate leaders have only recently reached a broad consensus in support of Mercosur.

Recent events suggest that Brazil no longer has the political will nor interest to liberalize further, beyond what was agreed to in the WTO. Brazilian trade policy has become increasingly defensive in response to the intensified demands for protection that have emerged in the current period of structural adjustment. In such an atmosphere, proposals for further liberalization are unattractive—especially vis-à-vis higher income, higher productivity economies, such as the U.S. and Canada. Instead, officials cite the priority of multilateralism to justify their decision to slow down the Mercosur process and their reluctance to negotiate new preferential free trade initiatives (like the Free Trade Area of the Americas).

Brazil’s Strategy for the Americas

As Mercosur developed into a customs union between 1990 and 1994, Brazilian policymakers considered three approaches to hemispheric integration. The first, which could be called “developmental protectionism”, would have continued traditional Brazilian trade policy from the era of import-substitution. Advocates of this approach paid lip service to multilateralism, not so much because they were committed to GATT rules and a global agenda, but mainly as a rationale to avoid subregional integration schemes like Mercosur. As Mercosur was consolidated and other subregional initiatives mushroomed, however, Brazil did not want to be excluded. This led policymakers to reject “developmental protectionism” as a possibility.

A second approach sought to combine Brazil’s preference for multilateral arrangements with active participation in Mercosur and the hemispheric integration process. Advocates of this approach argued that negotiating with the NAFTA countries should be a diplomatic and economic priority for Brazil because exclusion would be costly in a world of regional blocs. However, the few defenders of this view were not in decisive policymaking positions.

Brazilian policymakers ultimately opted for a third approach, which called for Brazil to remain committed to the negotiation and implementation of multilateral rules, and to break with the defensive stance it employed at the GATT in the early years of the Uruguay Round. In addition, Brazil would embrace Mercosur, while adopting an ambiguous, lackluster attitude toward such other subregional initiatives as NAFTA and hemispheric free trade. Beginning in 1994, proponents of this strategy championed the rapid creation of a South American Free Trade Area (SAFTA) through specific free trade negotiations between Mercosur and other South American countries.

Between 1990 and 1994, the third policy approach gained ground because Mercosur was considered successful. The European Union demonstrated interest in negotiating trade accords with Mercosur, and Brazil became less concerned about exclusion from NAFTA. In addition, resistance in the U.S. to the expansion of NAFTA reinforced the Brazilian
perception that joining NAFTA would not be a viable alternative for some time.

There is strong support in Brazil for the Cardoso Administration’s strategy to combine a program of trade opening with moderate doses of protectionism. Although Mercosur is Brazil’s top priority in hemispheric trade affairs, no effort is being made to deepen Mercosur by bolstering its institutions or harmonizing the domestic policies of its members in such areas as investment and industrial restructuring. Brazilian policymakers believe that political support does not exist for further liberalization within Mercosur. They now consider that the initial transition phase, with its massive tariff cuts between 1990 and 1994, may have been too rapid. In this view, Mercosur’s transformation into a full-fledged free trade area may require a second transition phase, lasting to the end of the century.

Brazil has, on occasion, failed to respect its obligations to Mercosur. When it raised tariffs and placed quotas on auto imports in 1995, for example, it initially treated Mercosur products no differently than those of other countries. These actions suggest that Brazil does not want to be the political and economic “locomotive” of the subregional integration process. If it were to take a leadership role, Brazil would have to grant disproportionate concessions to its Mercosur partners in order to sustain the process politically. Brazil’s enthusiasm for Mercosur has declined as its overall trade policy has become less liberal. The Brazilian view is that deepening Mercosur is not realistic in the near future.

Brazil’s unilateral trade measures following the Mexican crisis created further tensions within Mercosur and delayed plans to link Mercosur with other South American countries. Negotiations have been held between Mercosur and Chile on signing a free trade agreement. The outcome has been an association agreement, to be signed on July 1, but Brasilia has not yet articulated the structure of future bilateral Mercosur accords. Furthermore, Brazilian policymakers have ceased promoting SAFTA as an objective.

The fact that SAFTA has been put on hold, however, should not obscure the significant evolution of Brazil’s foreign policy toward its neighbors. Brazilian officials actively engage their subregional counterparts, and no longer hold the view that the countries around Brazil should be captive markets for Brazilian products. The spread of preferential trade agreements between neighboring countries has contributed to the new direction of Brazilian diplomacy toward South America.

Brazilian policymakers have given significant attention to the hemispheric process initiated at the December 1994 Miami Summit, but they believe it will be difficult to create the agreed upon Free Trade Area of the Americas (FTAA) by 2005. Brazil has three concerns: (1) the proposed deadline for achieving the FTAA; (2) whether the FTAA should be forged by using the subregional accords as building blocks, as Brazil desires, or by extending NAFTA, which seems to have been the U.S. proposal, at least until recently; and (3) the scope of the proposed agreement, i.e. whether provisions and disciplines should exceed those of the WTO, and if so, which ones. As a Brazilian analyst has remarked with regard to the last issue, “the United States has been trying to use the talks on hemispheric integration for the promotion of trade standards which go far beyond the Uruguay Round and would shorten the duration of transition regimes”, (Abreau, 1995).

Rather than negotiate even stricter disciplines, Brazilian officials argue that the country should use the next few years to implement and adjust to the rules and principles already agreed to in the WTO. In addition, the Brazilian government is concerned about the foreign policy implications of hemisphere-wide trade negotiations. Specifically, it fears that such negotiations might cause friction with extra-regional trading partners, and could reduce Brazil’s freedom to negotiate other trade arrangements.

Accordingly, many Brazilian policymakers view the time line set forth in Miami (i.e. that the FTAA negotiations be concluded by 2005) as a “conditional” rather than a binding commitment. They see the date as a target, subject to change depending on circumstance, rather than as a definite deadline reflecting the collective will of the 34 heads of state who signed the Miami Declaration.

From the Brazilian standpoint, the most important considerations determining the pace of

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2 It is worth noting that, in Brazil, both liberal traders and those who favor more protectionist policies are opposed to giving top priority to the FTAA talks, and to holding speedy negotiations with NAFTA.
negotiations are: (1) whether the FTAA’s agenda focuses on removing barriers to trade in goods, as preferred by Brazil, or on strengthening disciplines in areas of interest to the U.S., such as services, government procurement, intellectual property rights and competition policy; (2) progress made in the expansion of NAFTA; (3) the treatment of the regulatory and sectoral issues which are related to the nature of the transition regime, and costs associated with integration; and (4) the progress made in expanding Mercosur toward a SAFTA. The progress of free trade negotiations between Mercosur and the European Union may also influence Brazilian authorities, although to a lesser degree.

The Impact of a Brazil-U.S. Free Trade Agreement

A bilateral free-trade agreement between Brazil and the United States should yield net economic benefits for Brazil. The high concentration of intra-industry trade in manufactured goods between the two countries, among other features, suggests that gains for Brazil from improved access to the U.S. market should exceed losses from increased U.S. import competition. In addition, such a pact promises to generate new U.S. direct investment, and allow for the benefits of product specialization.

Of course, the size of any potential gain on the export side depends on the extent to which U.S. barriers to Brazilian products are truly eliminated. According to many Brazilian policy officials, the gains will only be significant if access of Brazilian goods improves quickly through a dramatic, unconditional reduction of existing barriers. The precedent set by NAFTA’s lengthy tariff and non-tariff-barrier phase-out periods for import-sensitive U.S. goods casts doubt on whether this can be achieved.

Losses in Brazil due to competition from U.S. exports will likely be limited because U.S. sales in Brazil are concentrated in sectors protected by high Brazilian tariffs and non-tariff barriers. The preferential reduction of tariffs and the easing of non-tariff barriers is more likely to create rather than divert trade.

To avoid conflict with Brazil’s diverse global economic interests, a bilateral pact cannot discriminate against trade and investment flows between Brazil and its extra-regional trading partners. NAFTA’s restrictive rules of origin may be cause for concern in this regard, because their application in the case of Brazil could potentially generate high levels of retaliation and trade diversion (remember that neither Mexico or Canada is a diverse global trader). They also could considerably reduce the dynamic benefits of any bilateral accord.

Another concern for Brazil is that the costs of the necessary structural adjustments would be higher than those resulting from unilateral liberalization—particularly in the industrial sector that now enjoys protection, and in which the U.S. enjoys a comparative advantage. Similarly, the harmonization of Brazil’s domestic laws and regulations with NAFTA rules may be painful. NAFTA rules are less tolerant of national differences than current WTO rules.

Hemispheric Integration:
A Proposal in Search of a Model

Any path that is to lead to the successful creation of a Free Trade Area of the Americas must ultimately involve negotiations between Mercosur and NAFTA. That is assured by the economic and political importance of the United States and Brazil in the hemisphere. With NAFTA and Mercosur already consolidated, neither the United States nor Brazil is likely to consider negotiating a bilateral arrangement—even though this would create enormous negotiating momentum that could spill over to the rest of the Americas.

Direct Mercosur-NAFTA negotiations would seem to make the most sense, but U.S. and Brazilian decision-makers seem to favor alternative strategies. The United States appears to support the gradual extension of NAFTA to the rest of the hemisphere, by incorporating those countries that meet certain readiness criteria, as defined by the original three NAFTA members. In Brazil, this approach is seen as imposing a regulatory model that exceeds the WTO disciplines, and would probably be rejected.

For its part, Brazil assigns top priority to (1) further consolidating Mercosur by the end of the century and (2) negotiating with its South American neighbors to convert the bilateral pacts that each Mercosur member has with those nations to plurilateral pacts that take account of Mercosur’s Common External Tariff. It is now believed that such negotiations will take longer than initially planned. Under this scenario, negotiations with NAFTA could only begin at a subsequent stage, after the creation of SAFTA or its equivalent,
by foreclosing the possibility of Brazil becoming “isolated” within the region. This negotiating strategy is part of the defensive nature of Brazil’s response to hemispheric trade liberalization, which is also evident in Brazil’s adoption of increased protection to combat auto imports from Mercosur countries and Brazil’s refusal to pay even a small price in order to make Mercosur a political success in the other member countries. Brasilia’s attitude may remind Washington of Brazil’s protectionist legacy and the style of diplomacy which accompanied it. This will hardly motivate the United States to begin NAFTA-Mercosur talks. Brazil, in turn, lacks enthusiasm for such talks because of its view that the U.S. goal is to extend NAFTA.

Despite the recent difficulties, there should be no doubt that the progress made by Latin American countries toward macroeconomic stability and trade and investment liberalization has sharply increased the prospects for hemispheric integration. To take advantage of this historic opportunity, both the United States and Brazil must adjust their preferred negotiating paths. Washington must be able to assure the rest of the region that its objectives have changed from those it pursued in its trade diplomacy of the 1980s, which Latin American nations saw as an aggressive unilateralism in search of an alternative to multilateral trade arrangements. For its part, Brazil should replace the defensive and protectionist remnants of its trade policy with a regional activism that is compatible both with its dedication to multilateral rules and hemispheric trends.

A blueprint on free trade is needed to rally a political coalition in support of NAFTA-Mercosur negotiations. It should call for the benefits and obligations of any accord that is reached to be extended to the other subregional agreements in the hemisphere within a fixed time frame (Hinojosa-Ojeda, Lewis & Robinson, 1994). It should also ensure that negotiations include the phase-out of all tariffs and non-tariff trade barriers, as well as provisions for harmonizing the participants’ trade and investment-related domestic regulations. And it should call for the inclusion of special financing mechanisms and institutions in at least three areas: (1) structural adjustment for the most vulnerable sectors and regions; (2) environmental protection; and (3) infrastructure.

A NAFTA-Mercosur agenda which included these features could reinvigorate hemispheric efforts to achieve freer trade and investment. It would encompass the widely shared regional priorities of liberalizing border measures and domestic regulations, and also effectively deal with issues that threaten the success of the effort politically. The need for any free trade initiative to include measures to foster economic and social development is underscored by recent experience in Latin America. That experience has demonstrated that the transition to more liberal economies does not automatically lead to economic growth and social improvement.

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