

THE GEORGE WASHINGTON UNIVERSITY

INSTITUTE OF BRAZILIAN ISSUES

THE MINERVA PROGRAM

THE THEORY AND OPERATION OF A MODERN NATIONAL ECONOMY

BRAZILIAN TRADE: TOWARD THE AMERICAS?

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FALL 1998

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Introduction

The Brazilian trade pattern has changed deeply in the '90s. The process of economic openness to international trade, the formation of Mercosur, the globalization and the economic stabilization program (The Real Plan) were the main causes.

This liberalization raises another questions to think about: what should be the Brazilian foreign policy in face of all these changes? Should Brazil concentrate its trade with its South American neighbors, or even all the American Continent countries, or should it pursue multilateralism? What does the recent trend show us?

In the face of these questions, the recent change in the Brazilian macroeconomic policy, that includes the opening to the rest of the world will be analyzed.

The statistics will show how Brazilian international trade grew in this decade. There was a significant increase in imports and, to a lesser degree, in exports. As a consequence, Brazil's trade balance has produced an increasingly larger deficit since 1994. The destination of Brazilian exports and origin of Brazilian imports has deeply changed with the creation of Mercosur and the increase of trade with its South American neighbors and the United States. Significant change can be observed in the composition of trade - Brazil has been being a big purchaser of capital goods, as its industry needed to replace its old machinery to be increasingly competitive.

All this data will be analyzed to highlight the trends that have been observed relating to this issue, especially the trend to concentrate trade among countries of the American continent, as the rest of the world has been adopting the same trade strategy, i.e., the formation of free trade blocks with their neighbors.

This final paper will also include a brief about Mercosur, the custom union formed by Brazil, Argentina, Uruguay and Paraguay, one of the most important initiatives of Brazilian foreign policy in this decade. Since the initial negotiations, trade between the partners has been increasing very quickly in a great variety of goods and services. Especially between Brazil and Argentina, there is significant complementarity of economic activities, so there were a lot of trade opportunities that couldn't happen with the tariff barriers that existed before the formation of the custom union.

Recently, the objective of a free market all over the American Continent has been debated again. Since the last Summit in Santiago (april'98) it was decided that the negotiations might be finished in 2005, but there are many controversial opinions about this subject. The main proposals/objectives of the Free Trade Agreement of the Americas - FTAA and its possible gains and losses for a less developed country like Brazil will be analyzed, as well as the next steps in the negotiations, and the relevance of Mercosur in this process.

The last discussion will be about the foreign policy alternatives for Brazil in face of the recent changes in the international trade pattern, that means, will the country continue to pursue the traditional multilateralist policy or will it walk-in to a major trade agreement between the American continent countries?

Chapter 1: Brazilian liberalization policy: a historical brief

The expected inflation in Brazil for 1998 is below 3%. This is a uncommon situation for many Brazilians that have learned to survive with high rates of inflation in the last 20 years. Especially in the '80s, after the second oil shock and the external debt crisis in Latin America, Brazil had to face a chronic inflationary process, that has been solved only in 1994. Succeeding governments - and even succeeding Finance ministers and Central Bank presidents during the same government - issued no less than 6 anti-inflation stabilizing plans from 1986 to 1994.

The increase in the international interest rates after 1979 severely affected the Brazilian economy, because the country had based its development on international loans, that were cheap and abundant until the 1979 crisis. After that, the external debt saw an expressive increase, that forced the country to adopt restrictions to imports, international trips and remittances of profits and, as well, a program to stimulate exports. This new scenario of shortage of resources restricted the investment capacity of the country in the '80's, which came to be known as the "lost decade" for Brazilians. During that 10 years, the average GDP growth was only 1.3% a.a. and inflation reached 2,489% in 1993.

Besides the macroeconomic unbalance, that situation didn't allow for the modernization of the country because the lack of foreign competition did not provide incentives to the local producers and even those entrepreneurs that asked to import machines and equipments to improve its production had to face many kinds of bureaucracy and foreign exchange restrictions, which made it almost impossible to purchase anything from abroad.

At the end of the 80's the situation improved with the beginning of the external debt renegotiation, which normalized Brazilian relations with the international financial community. The Uruguay Round negotiations also moved forward at that time, with the active participation of Brazil, which made it more committed to its own liberalization program. Once the renegotiation of the external debt came to an end, a new reversion of capital flows took place. First volatile capital and then productive investment also: direct investments in Brazil grew from a flow of US\$89 million in 1991 to US\$14.5 billion in 1997.

In 1989 the first presidential election after 25 years of military dictatorship took place and the elected president was appointed in march, 1990. The new government began a wide program of reforms to modernize the country, which included privatization and the opening of the country to the international competition. It was, and it is, a revolution, with losers and winners.

The liberalization process happened in two different steps: the first, which took place in 1988 and 1989, was characterized by changes in the external tariffs, the end of the import special regimes, the unification of the many taxes applied to the imports and the reduction of the tariffs from an average of 51% to an average of 37%. The second step began in 1990 with the definition of new guidelines for the industrial and international trade policy. The reduction of the brackets was planned so that, at the end of 1994 the average tariff would have been 14%.

The liberalization schedule was maintained until October 1992, when the government anticipated the tariffs reduction foreseen for 1993 and 1994.

Table 1 - Tariff liberalization - 1990-2006							
	1990	1991	1992	1993	1994	1995	2006
Average Tariff	32%	25%	21%	13%	11%	13%	12%
Source: Moreira, Maurício M. e Correa, Paulo G./BNDES, 1996							
Obs.: The exceptions list of MERCOSUL is prescribed to finish in 2006.							

Since 1994, the import tariffs policy is guided according to the objective of price stabilization - so many tariffs of basic goods was set to 0%, which was meant to prevent a raise in prices. In September 1994 a single external tariff went into effect among Mercosur members.

Those liberal measures, in conjunction with the increase in the total demand, as well as the appreciation of the Brazilian currency that was set just after the Real Plan (June, 1994), produced trade deficits and intensified the demand for protection of some economic sectors, what led to the increase of some tariffs in 1995 (refrigerators, freezers, televisions, cars, etc). The macroeconomic objective of price stability, as well as the commitments assumed with the World Trade Organization - WTO and with Mercosur members led to a new reduction of these tariffs in the last 3 years.

Simultaneously to the openness to the international trade, Brazil initiated the liberalization of its capital account with the introduction of the flexible exchange rates for tourism. The increase in convertibility continued with the increase of the limit to the purchase of foreign currency for tourism abroad, the official authorization for the unilateral transfers and for Brazilian investments abroad. This process was strengthened in 1990 when financial institutions were authorized to keep unlimited foreign currency, the enlargement of the foreign assets that Brazilians could invest and, specially, with the permission given to foreigners to invest in the Brazilian financial market.

The impact of the trade liberalization varies depending on each economical sector, but it can be assumed that the industrial sector was the most affected. Many industrial sectors, specially the small and medium companies, have not been answering to the new situation with the velocity and depth required in order to provide an industrial, job and export expansion. An indication of this problem is that the industrial sector grew 18% less than the Brazilian economy as a whole in the period of 1993/96.

Besides the negative effect on Brazilian industries, in general, it can be assumed that trade liberalization brought gains to the population welfare, compared with the data from the '80s. Today we can see a more modern country, where people have a more variety of products and with lower prices. Imported goods have been a fundamental weapon against inflation and the low inflation represents a net wealth gain, especially for poor people, that can't protect themselves against the loss of nominal wages. What can be contested is the great velocity of this openness, that did not permit that all economic sectors to adapt themselves to the new situation, as demonstrated by the cities, especially big ones, that were overwhelmed by the unemployment problem.

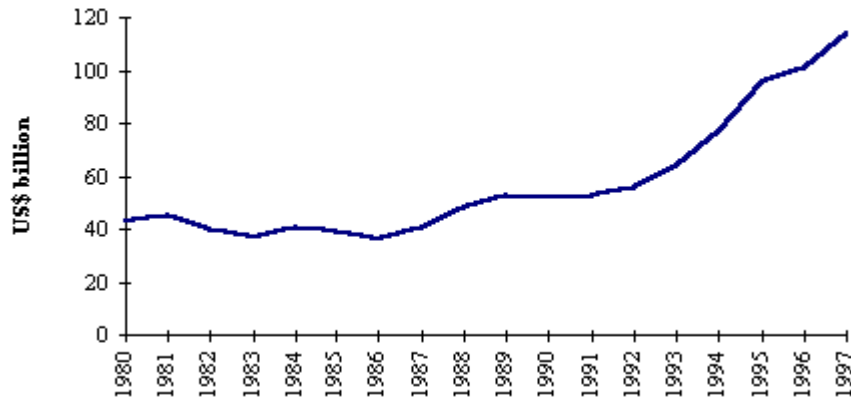
The commitments assumed with the WTO and Mercosur assure greater access to foreign markets, but also restrain the decisions of policy makers. These issues make the task of increasing the external competitiveness of the Brazilian economy more urgent and demand a serious competence to manage the commitments assumed by the country and (perhaps, above all) to properly defend the national interest in the present and future multilateral negotiations.

Chapter 2 - Some trade statistics since 1990

Trade flows

An analysis of Brazilian external trade statistics shows a significant increase in Brazilian participation in international business, by the growing of the imports, exports, capital flows, tourism and services. While in 1990 exports represented 7% of Brazilian GDP and imports 5%, this relationship was, in 1997, 6.6% and 7.6%, respectively (see graph 1 about trade flows). Other examples are that the number of international Brazilian bond issued was 1,837 in 1991 and this number grew to 14,722 issued in 1997, the Brazilian tourists spent US\$5,2 billion abroad in 1997.

Graph 1 - Trade flows (imports + exports)



Trade balance

As it was already analyzed in the chapter I, imports substantially increased in the '90s, because of the investment requirements in several economic sectors and because of the stabilization program (Real Plan - 1994). While exports grew 70%, imports increased 200% in just 7 years. As the increase of imports has been larger than the increase of exports in the last 3 years, Brazil has been faced with its first trade deficits since 1980. Table 2 shows the Brazilian trade balance performance.

Table 2 - Trade Balance					
Year	Exports	%	Imports	%	Net balance
	US\$ bill	variation	US\$ bill	variation	US\$ bill
1990	31.4	-8%	20.7	13%	10.8
1991	31.6	1%	21.0	2%	10.6

1992	35.8	13%	20.6	-2%	15.2
1993	38.6	8%	25.3	23%	13.3
1994	43.5	13%	33.1	31%	10.5
1995	46.5	7%	50.0	51%	-3.5
1996	47.7	3%	53.3	7%	-5.6
1997	53.0	11%	61.4	15%	-8.4
Source: SECEX/MICT					

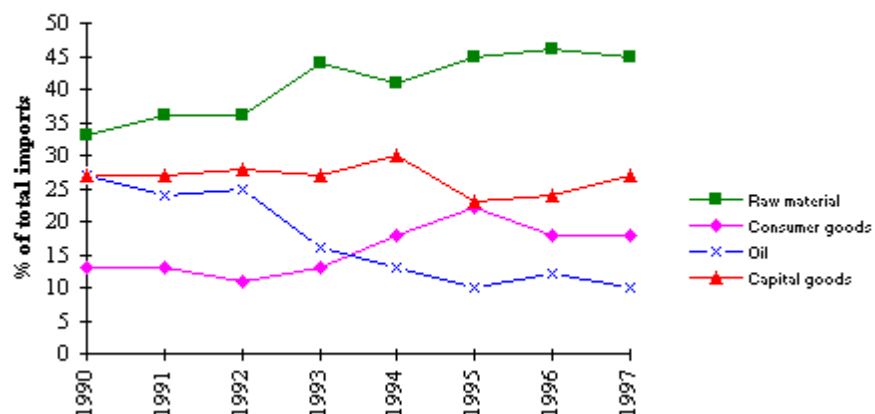
That deficit in the trade balance has been compensated by the inflows of foreign capital, that are invested in financial markets, stock markets or direct investments. The Asian crises, that was spread to other emerging markets, raises the question about this external resource dependency, since most of this capital is speculative and it leaves the country in face of the smallest signal of non-confidence.

Traded Goods

Continuing to analyze the trade balance, not only has the volume of exported/ imported goods changed, but also the composition of trade. On the side of the imports, an increase in the participation of raw materials (especially chemical products), consumer goods and also capital goods can be observed. This has been encouraged, in the last 2 years, by the privatization program, that demanded a massive investment in new machines and equipment (the annual average of the machine imports for the 1993-96 period reached US\$17 billion, overcoming 80% of the average of the 1990-92 period).

Among durable goods, the car imports, that only in 1997 had an increase of 58% over the last year, can be highlighted. Imports of other durable goods decreased 38%, especially electronics and textiles, which shows that initial Brazilian consumption fever is over and it also shows that the local industry is getting a positive answer to external competition.

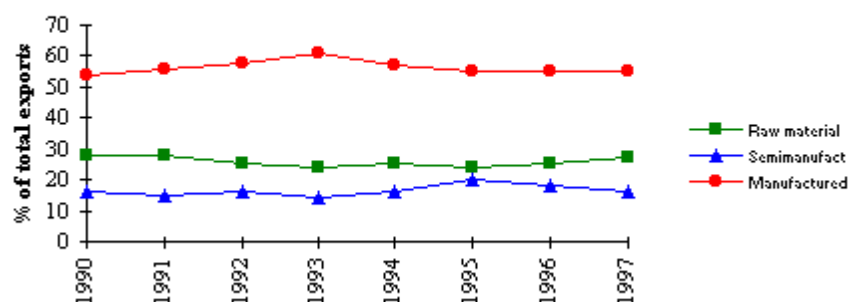
Graph 2 - Imports: group of products



Source: MF/SRF

Regarding exports, a composition stability among raw materials, manufactured goods and semi-manufactured goods can be observed. A VAT exemption for commodity exports was instituted in 1996, but its full impact was felt only in 1997. The insufficient dynamics of the exports, in a context of significant expansion of the imports stimulated by the economic opening seems clear.

Graph 3 - Exports: group of products



Source: MICT/SECEX

Origin and destination of Brazilian trade

In this decade, trade flow has increased, the list of exported/imported products has changed and also the origin and destination of these products has been deeply modified. Until 1990 the statistics showed the multilateral trend of the Brazilian foreign policy: trade was fairly distributed among the Americas, Europe, Asia, Middle East and, in smaller proportion, Africa.

In the beginning of the 90's Mercosur was launched, whose free trade area and, later on, custom union, was consolidated in the last 4 years. That agreement allowed for Brazilian exports to those countries to grow 7 times and imports to increase 4 times between 1990 and 1997. A growth in the trade with the USA - the annual imports increased 218% between 1990 and 1997, but the Brazilian exports grew only 21% in this same period - can be also verified. Table 3 shows the distribution of the Brazilian exports among several countries/blocks of countries in 1990-97 and table 4 shows the distribution of imports for this same period.

	1990	1991	1992	1993	1994	1995	1996	1997
Europe	32.36	31.93	30.10	26.43	28.02	27.76	26.88	27.40
USA	24.57	20.12	19.72	20.72	20.56	18.91	19.50	17.59
MERCOSUR (1)	4.20	7.30	11.44	13.97	13.59	13.23	15.30	17.21
Asia	16.77	17.99	15.59	15.85	16.19	17.61	16.36	14.53
Rest of ALADI (2)	6.03	8.35	9.76	9.68	8.84	8.12	7.60	8.59

Source: MICT/DECEX/GEREST

(1) MERCOSUR: Argentina, Paraguay, Uruguay

(2) Rest of ALADI: Bolívia, Chile, Colômbia, Equator, Mexico, Peru, Venezuela

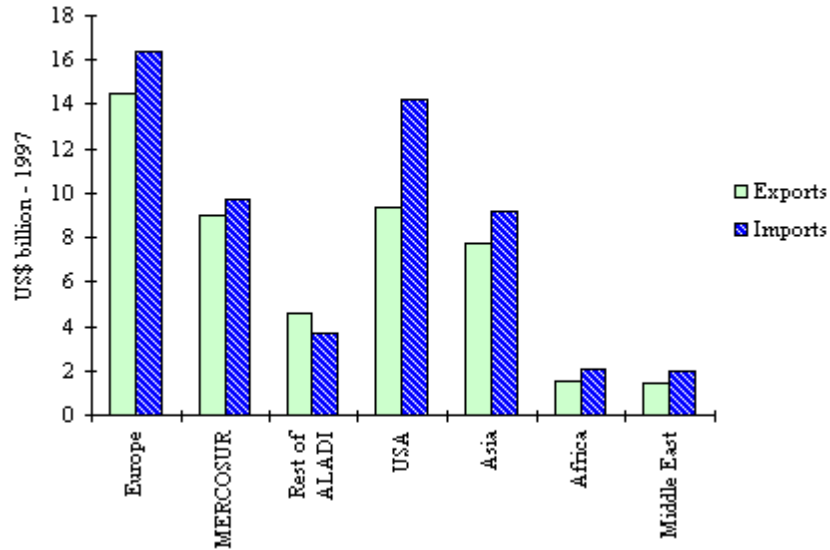
	1990	1991	1992	1993	1994	1995	1996	1997
Europe	22.27	24.00	23.76	23.54	27.12	27.68	26.44	26.59
Asia	8.47	9.08	10.58	14.57	15.03	16.53	14.21	14.94
USA	21.45	23.66	22.47	20.44	20.52	21.12	22.20	23.34
MERCOSUR (1)	11.11	10.95	10.67	13.44	13.90	13.60	15.51	15.81
Rest of ALADI (2)	6.11	6.51	7.23	5.35	5.22	6.33	6.13	6.02

Source: MICT/DECEX/GEREST

1) MERCOSUR: Argentina, Paraguay, Uruguay

The evolution of the trade demonstrates that, nowadays, Brazil has a significant trade deficit with USA, but this negative balance is compensated by the surplus with Latin America as a whole. The graph 4 shows the balance of the Brazilian trade with the main countries/blocks.

Graph 4 - Trade with relevant trade/blocks



Sources: MICT/SECEX and SRF

In 1997, the main destination of the Brazilian exports was USA (17.5% of total), Argentina (12.8%), Netherlands (7.6%), Japan (5.8%) and Germany (4.9%).

Considering only Mercosur, Brazilian exports reached US\$9 billion in 1997, and most of those exports were manufactured products, especially vehicles.

Brazilian exports to Europe were about US\$14.5 billion in 1997, mainly basic products as soy and coffee. As the first market for Brazilian exports, USA bought US\$9.3 billion, especially manufactured goods, such as shoes, engines, airplanes, etc.

The biggest increase in imports in 1997 was observed with the trade with USA: +21% comparing with 1996 and included computers, airplanes and communication machines (USA is the major Brazilian supplier of this kind of good).

Aladi is the second biggest supplier, reaching US\$13.4 billion, mostly because of the Mercosur performance. Argentinean participation, that sells to Brazil vehicles, its parts, oil and wheat should also be highlighted.

The mainly products from Europe were durable goods (specially vehicles and its parts). Imports from Asia reached US\$9.2 billion and Japan was the most important supplier within Asia, selling electronic goods, circuits and vehicles.

Direct investment

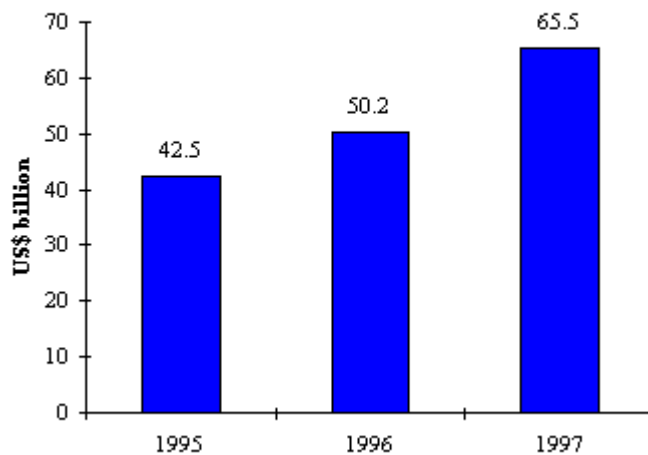
In a globalized world like today, transnational companies play a major role, because a significant part of the world trade is done between these companies. Estimates indicate that transnational companies are already responsible for about 50% of international trade.

The intra-industrial trade permits efficiency gains to the companies because of the specialization and permits welfare improvements for the population that has a bigger access and more possibilities of choice between goods. In Latin America Latin and Brazil, this intra-industrial trade has been growing, as it can be shown in table 5.

Products	EUA/Canada		Europe	
	1970	1987	1970	1987
Manufactured	2.6	12.8	2.0	8.6
Transport Equip.	2.2	17.4	2.3	8.6
Other manufactured	2.6	9.0	1.3	9.5
Source: Baumann (1991) in Thorstensen, Vera et alli				

In fact, Brazil is a major destination for direct investments (see this evolution on the graph 5), that is applied especially in the transformation industry and, more recently, in the service sector (banks) and infrastructure, because of the privatization of the telecommunication and energy companies.

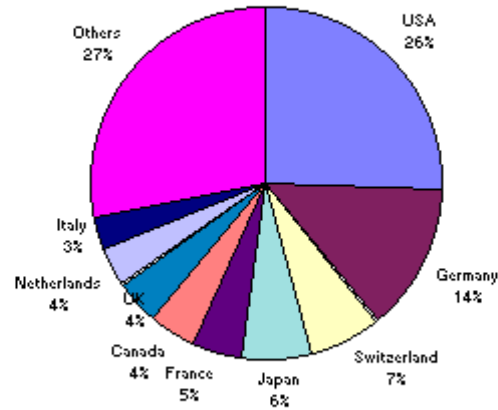
Graph 5 - Foreign investment stock



Source: Brazilian Central Bank

American companies are the biggest investors in Brazil, followed by German and Swiss companies (see graph 6).

Graph 6 - Foreign direct investors in Brazil



Source: Brazilian Central Bank

Such American investments are reflected, as we have already analyzed, in Brazilian international trade. In 1997, among the 10 biggest export companies in Brazil, 5 were multinationals (2 American companies). Among the 10 biggest importers, 6 were multinationals (2 American companies).

Chapter 3 - Mercosur formation

Mercosur, The Common Market of the Southern Cone formed by Brazil, Argentina, Uruguay and Paraguay, was one of the most important initiative in Brazilian foreign policy in this decade. Since the initial negotiations, trade between the partners has been increasingly very quickly in a great variety of goods and services.

Mercosur was created on March 26, 1991, when these four countries signed the Treaty of Asunción. The two main instruments of the Treaty were a four-year trade liberalization program and a commitment to implement a common external tariff by January 1, 1995. Preceding the Asunción Treaty was the signature in 1986 by Argentina and Brazil of the "Ata para a integração Brasil-Argentina". This new accord aimed at expanding bilateral trade between the two countries by adopting a sectional approach. Two other accords, signed by Argentina and Brazil preceded MERCOSUR: the "Tratado de Integração" in 1989, and the "Ata de Buenos Aires" in 1990. A meeting held in August 1990 with Uruguay and Paraguay led to the Asuncion Treaty in March 1991.

On December 17, 1994, the presidents of the four MERCOSUR countries met at Ouro Preto in Brazil to sign a document that set January 1, 1995 as the implementation date of a common external tariff, that should range from 0% to a maximum of 20%. Each country was allowed a list of exceptions which will be phased out in five years for Argentina, Brazil and Uruguay and ten years for Paraguay. Domestic tariffs will converge to a maximum of 14% by 2001 for Argentina and Brazil and 2006 for Paraguay and Uruguay in the case of capital goods, and to a maximum of 16% by 2006 for information technology products, which might reach lower levels.

Trade and capital movements have already reached significant levels, as well as the political importance of the group in the presence of international forums. Mercosur has exceeded the most optimistic expectations - the four countries presented, in the first half of this decade, a quite favorable economic performance. In 1997 the total intra-regional trade among Mercosur countries reached US\$20.3 billion, that was 5 times bigger than the intra-trade verified in 1990. That increase in trade helped countries in their processes of stabilization of prices and it made possible productivity gains because of the easy access to input and capital goods. Despite this intra-block trade increase, trade with the rest of the world continued to grow, with an annual average rate of 7.3%.

This new policy provided the catalyst for restarting the growth process and some gains in terms of social well-being. The GDP per-capita increased 10%, that is more than the growth of other groups of countries of the American continent, as shown in table 6:

Area	GDP per capita		Variation
	1991	1996	1996/1991
MERCOSUR	2,926	3,210	9.7%
Andean Group	1,769	1,915	8.3%
CAMC	927	991	6.9%
Caribbean Comm.	2,719	2,772	1.9%
NAFTA	17,232	18,280	6.1%

Source: IDB

Andean Group: Bolivia, Colombia, Ecuador, Peru and Venezuela;

CACM (Central American Common Market: Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua;

Caribbean Comm.: Antigua and Barbuda, Barbados, Bahamas, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad Tobago,

The increase in foreign trade, that contributes to these numbers, is clearly associated to the easy access to the regional markets, especially because of the trade blocks arrangements. Mercosur's intra-regional trade represented, in 1990, 11% of the total exports, but in 1997 this share has already doubled.

In fact, in 1996, intra-regional markets to the Mercosur were more important to the Mercosur exporters than the market of NAFTA, as shown in table 7. It can also be observed that the export destinations of the group is diversified, and half of the exports is sold to non-American continent countries:

	%
MERCOSUR	24.7
MERCOSUR+ Chile + Bolivia	29.7
Andean Group	4.6
CACM	0.4
NAFTA	16.3
Others	49.0

Source: IDB

Mercosur's share in the world total exports is still small, and all of the products that it has a participation of 10% or more are basic goods (meat, fruit, coffee, iron, etc). The share in total imports is even smaller and there is not a single good that Mercosur imports more than 10% of the world total imports.

Mercosur's custom union stimulated the manufactured goods trade among countries. These results can be associated with a "learn effect" that permitted an increased in the exports to intra-Mercosur countries because these are less sophisticated markets, which permits local exporters trade and production on a considerable scale, technical assistance, special marketing strategies and other key elements in order to be prepared to work with foreign customers all over the world.

Direct investments among the Mercosur countries

A first important indicator of the reaction of the worldwide companies to the Mercosur performance is the flow of the direct investments into the countries. Table 8 shows the significant increase of the inflow of direct investment in Latin America as a whole in the first half of the '90s. But these numbers also demonstrate that Mercosur had the most percentile increase among American continent trade blocks. In 1995, the inflow of direct investments in Mercosur was 10 times greater than it was in 1990.

	1991	1995	% increase
MERCOSUR	3.0	32.5	980%
Andean Group	3.6	8.0	120%
Caribbean Community	0.5	0.1	-400%
Total Latin America	34.3	57.8	68%
NAFTA	80.4	148.6	84%
Source: IDB			

As important as those numbers is the information that the direct investment among the Mercosur countries also increased in this decade. Accordingly to the Economic Commission for Latin America and the Caribbean (ECLAC), the number of Brazilian companies with representative offices, factories or subsidiaries in Argentina was only 20 in 1990 but reached to 400 in 1997, while more than 80 Argentinean companies invested in Brazil.

Brazil and Mercosur trade

Trade between Brazil and the other Mercosur countries have been growing since 1990, as many exports as imports. This performance can be seen in table 9:

	Exports	Imports	Balance
1990	1.3	2.3	(1.0)
1991	2.3	2.3	0.0
1992	4.1	2.2	1.9
1993	5.4	3.4	2.0
1994	5.9	4.6	1.3
1995	6.2	6.8	(0.6)
1996	7.3	8.3	(1.0)
1997	9.0	9.6	(0.6)
Source: SECEX/MICT			

In 1997, exports to Mercosur corresponded to 17% of the total Brazilian exports and imports were equivalent to 16% of the total imports in that year. The exported goods were relatively diversified, with a great share for middle and high intensive technology. Imports are basically of food or middle intensive technological manufactured goods, such as textiles and chemical products.

An important complementary economic activity is observed among the countries. Brazil and Argentina, as the major industrialized countries in South America, could increase their share of manufactured goods market in the region. Uruguay and Paraguay supply basic products or less sophisticated manufactured goods. Argentinean main products are oil, vehicles and temperated weather agricultural products. One of the objectives of Southern Cone integration was to link the most dynamic and competitive sectors of each country to enhance their ability to compete in international trade.

Argentina is the most important market for the Brazilian exports and imports. In 1997, the Brazilian exports to that country reached US\$6.8 billion and imports reached US\$8.2 billion. Exports to Uruguay were about US\$870 million and imports were US\$981 million. Brazilian trade with Paraguay was: Exports of about US\$1.4 billion and imports of US\$532 million.

Considering the increase of the trade flows, the diversity of the Brazilian exports to the member countries, the tendency towards economic stabilization and the economic growth of these countries, it can be concluded that this is a market of extreme importance and potential to the Brazilian policies.

Mercosur in the world trade

Mercosur population corresponds to 3.8% of the world population, its GDP was 3.4% of the world GDP, but its exports and imports correspond to only 1.6% and 1.7% of the world total (base 1995). Compared with 1990, when the participation of exports and imports were respectively 1.5% and 0.9%, there was a progress in the presence of Mercosur in the international scenery.

The integration among the countries of the South Cone is illustrative of a movement that was initiated as a political decision and was surrounded by skepticism, could be capable of generating results of unexpected magnitude and it is, gradually, assuming continental importance.

The formation of Mercosur has been, until now, a reasonable process that has attracted other countries. Since 1996 both Chile and Bolivia have signed free trade agreements with Mercosur.

There is a perception that the economic results reached recently by Mercosur - with the learning that the single participation of a block in international forums can result in gains within other integration process, - has granted these countries a more active performance in the international markets that has attracted the attention of other developed countries. This argument - together with the macroeconomic discipline imposed by the agreements - has justified the internal efforts to preserve the cohesion among these 4 countries.

This element has a fundamental importance to the analysis of the Mercosur position in face of other countries/blocks trading partners since there are many issues that require a single position from its members, for example the creation of the FTAA. While some countries propose a quick elimination of the existent trade barriers as a form of assuring the consolidation of FTAA, the members of Mercosur defend that the FTAA should be the result of a convergence of the existent sub-regional agreements, in a gradual process.

The current non-economic dependence of the members of Mercosur to any economic power country/region may be considered from many viewpoints. It could mean being condemned to a marginal position with no return. It can also mean the possibility of establishing cooperative links with every trade bloc of free trade area. It can even mean the ability to choose between different forms of integration into each area or bloc. It can also bring South America the advantages of being free to claim real multilateralism.

Chapter 4: The perspective of a Free Trade Area of The Americas - FTAA

In June of 1990, the Government of the United States proposed an initiative (the Initiative of the Americas) to promote economical cooperation with the American continent countries, motivated, at least officially, by the economic difficulties of the Latin American countries.

In a short period, the Initiative of the Americas intended to help the countries with problems of external debt and trade/capital liberalization. In the long run the objective was the formation of the Free Trade Area of the Americas - FTAA. The FTAA project was officially launched in December 1994, during the "I Cúpula das Américas", that took place em Miami.

The simultaneity of that process with the consolidation of Mercosur, as well as the liberalization of the Brazilian trade, has provoked a conservative position of Brazilian diplomacy with relation to the FTAA.

The recent evolution of the facts leads to believe that, however, it is more and more probable that some negotiation involving the American continent countries (except Cuba) will be taken until 2005, the deadline that was negotiated in the last meeting that took place in Santiago del Chile in April 1998. The negotiation program is ambitious, involving not only trade issues, but, also, the so called "new" issues, as services, investments, competition policies and the property rights. A number of principles that will give the directions to future negotiations, among them the consensus decision in all the issues, the coexistence of the FTAA with other bilateral or sub-regional integration agreements and the compatibility of the FTAA with the WTO deals has also been confirmed.

Brazil and the other members of Mercosur agree that, in the negotiations to the formation of the FTAA, they have to have a single and transparent position about future developments and the expected results. They consider that the negotiations should contemplate the essential interests of the 34 American continent countries and it must contribute to prosperity promotion of the population. To reach those objectives, in the opinion of the Brazilian diplomacy, the future negotiations should be developed in a gradual and balanced process, with gains for both sides. Besides this, the Brazilian economy is still assimilating the effects of the adverse shock caused by the trade liberalization of the '90s.

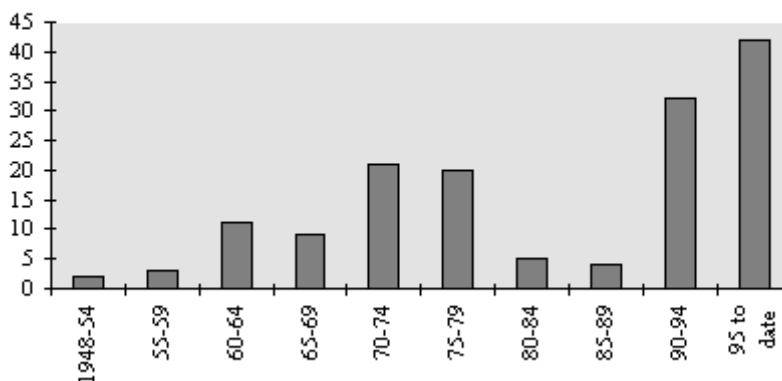
As the American countries markets are the most important markets to the Brazilian manufactured goods, Brazil must not passively contemplate the trade agreement arrangements in the region (only 25% of the Brazilian exports to USA and 20% of the Brazilian exports to Mercosur are intensive in natural resources).

The advantages of an integration agreement

The main motivation for the regional integration agreements have been the gains associated with the efficient use of resources that is generated by the creation of trade that can result of the removal of the tariff barriers. The traditional economic theory is based on trade creation and trade deviation concepts, focusing on the trade changes provoked by the regional integration. It's difficult to analyze this concepts in the face of the globalization of the production that, guided by the market forces, makes it difficult to analyze the gains and losses that arise with the creation and deviation of the trade. So, the analysis of an integration process should include the long run costs and benefits, that are related to the improvements of the economies of scale and the more efficient use of resources that is acquired with the enlargement of the market.

If the number of regional integration agreements notified to GATT/WTO (graph 7) in the last few years is considered, it can be deduced that these agreements have been useful to the countries. Ideally, the end result would be if all these free trade areas came together in a great free trade area, where everybody could have access to every product they desire.

Graph 7 - Regional integration agreements notified to GATT/WTO



Source: WTO

In reality, in the case of FTAA, different countries/blocks have different interests in relation to a continental free trade agreement. Small countries, with a big trade exchange with the USA tend to be favorable to this agreement. In this context, it could attract much more enthusiasm among the Central American and the Caribbean countries than among South American countries. The agreement could attract also:

- a. big countries with a significant trade with the USA and a big border with the USA, like Canada and Mexico;
- b. countries that have domestic security problems and receive some kind of help from the USA, like Peru, Bolivia and Colombia;
- c. countries that realized deep economic liberalization processes and now could have an agreement with the USA will be given considerable legitimacy within the IFC.

Two specific cases should be analyzed separately: Brazil and Argentina.

Brazilian external trade is small compared to its GDP (approximately 10%). Although the USA is the most important Brazilian trade partner, it purchases no more than 1/5 of all the Brazilian exports. Approximately 2/3 of the Brazilian exports to USA are manufactured products, but most of these products are actually submitted to non-tariffs barriers in the USA market (the classical case is the orange juice). The tariffs barriers are already low. So, for Brazilian interests, FTAA should include the elimination (or the decrease) of the American non-tariff barriers.

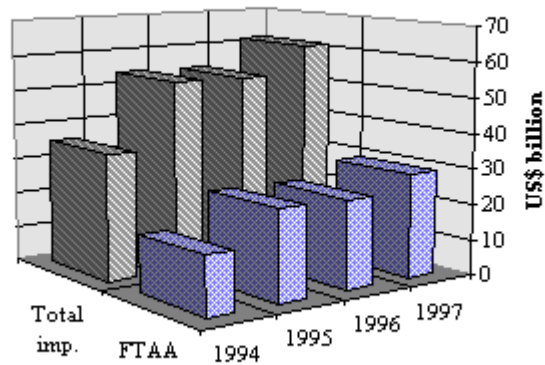
Regarding Argentina, there is a clear perception that the agreement with the north-American countries would be the decisive step to modernize its economy and increase its efficient and competitiveness. The integration process with Brazil (through Mercosur) helps to enforce its negotiation power.

In relation to USA, it has global trading interests, so its natural for it to pursue a variety of initiatives with leading trading nations of Asia, Europe and Latin America. In 1997, about 33% of US trade (exports and imports) was with the Pacific Rim countries; 30% with NAFTA members; 21% with the EU; and 2% with Argentina and Brazil. Mexico is the second biggest market for the American exports and Brazil is actually the 11th. So, US exporters have a growing and underdeveloped market for their goods in South America, and have been rapidly expanding their presence in those markets over the past five years. US exports to and imports from the region, excluding Mexico, have increased by about 50% since 1993, with the United States running a small surplus with the region each year (2/3 of this surplus is with Brazil). During that period, US direct investments increased by 30% on a historical-cost basis to a cumulative \$92.5 billion in 1995, representing 13% of total US foreign direct investment. FTAA would help reinforce these broad trends by providing substantial new liberalization by Latin America countries in return for guarantees of continued good access to the US market.

The trade between Brazil and the American continent countries

As it can be seen in graph 8, Brazilian imports from the FTAA countries are equivalent to 48% of the total imports in 1997. The main reason for this growth is the increase of the imports from the USA (+76% between 1994 and 1997). This data gives an idea of the growth potential for the American exports to Brazil, in the case of the FTAA accomplishment.

Graph 8 - Brazilian imports from FTAA x total imports



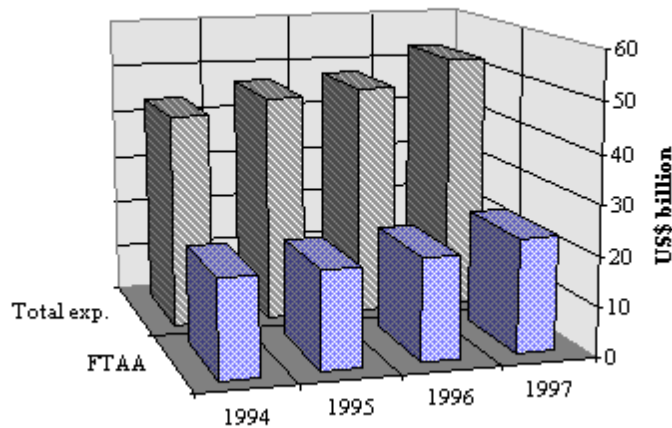
Source: MF/SRF

While the imports from FTAA countries corresponded to 48% of the total Brazilian imports in 1997, The European Union sold 27% and the Asian countries sold 15% of all Brazilian imports.

By the side of exports (graph 9), FTAA countries bought 44% of the Brazilian exports in 1997. The exports to USA increased only 4% (nominal) between 1994 and 1997, a fact that indicates the weakness of competitiveness of Brazilian products in the USA. The goods that Brazil produces more competitively are that subjected to non-tariffs barriers (orange juice, sugar, alcohol, etc).

Brazilian exports to Latin America as a whole grew 32% between 1994 and 1997. Exports to Europe corresponded to 27% and to Asian countries it was equivalent to 15% of all Brazilian exports in 1997.

Graph 9 - Brazilian exports to FTAA x total exports



Source: MICT/SECEX

Next steps to FTAA

The decision about the beginning of the negotiation process, that took place in the last summit in Santiago del Chile, was the final act after 4 years of discussions. The negotiations are expected to be concluded in 2005 and the implementation would take place between 2005 and 2020.

American domestic politics today tend to set a straight limit to foreign relations, which is momentarily an obstacle and a permanent factor of uncertainty about the extension of new free trade agreements. Until today, the President Bill Clinton couldn't get the "fast track" from the Congress that would authorize the American

executive branch to negotiate the FTAA. However, strong motivations in terms of interests in trade and investment, security reasons and the need to keep the leadership in the hemisphere still prevail, pushing the Executive to maintain a permanent pressure in favor of economic integration in the Americas.

Brazil has taken advantage of the denial of American Fast-track to postpone the agreement implementation and get more time to strengthen its position, as the Brazilian economy is still adapting to the liberalizing shock of the '90s. Brazil does not intend to oppose to the creation of a hemispheric free trade area, but wishes to establish as a previous condition the consolidation of the existing regional arrangements: Mercosur, Nafta and Andean Group.

The business community opinion

This opinion depends on the sector in which businessman/woman works. If they work in a import-competing sector, they have, obviously, many restrictions to the FTAA implementation. If they work in a sector that already faces a strong international competition, they tend to have a favorable opinion about the FTAA. This is true for the Brazilian and for the American business community.

Since the first Summit (1994), 4 business meetings (Denver, Cartagena, Belo Horizonte e São José da Costa Rica) have occurred that brought together business people from all over the American countries. They seek to influence government decisions in the negotiation process in order to prevent unfavorable agreements for the national economies as a whole and for their particular sectors.

The most controversial issue is the period of time that FTAA would be implemented. Brazilian business community asked for a fair period of time in order to provoke the smallest impact on the Brazilian productive system.

The Brazilian business people fear competition from the USA, since Brazil already has an expressive trade deficit with that country (US\$5 billion in 1997), especially electronic equipment and computers. They also ask for the end of the non-tariff trade barriers against some Brazilian products in the USA.

Except for the orange and sugar producers, American business community seem to be more favorable to the FTAA than the Brazilian. Brazil is a big country, with a big consumer market, and it lacks infrastructure, capital goods, durable goods, etc, that means, it is a great market for the American producers, in spite of the small purchasing power of the Brazilian population.

In a certain way, there is a consensus among the business community that the country needs to be exposed to foreign competition to stimulate the modernization and the efficiency. The USA is a big market for the Brazilian goods also, but the Brazilian government should be very careful with the pace of the FTAA implementation.

Chapter 5 - Final considerations

Brazil has been adopted a multilateral foreign policy in the last decades that aims to trade with many countries, avoiding concentration with any of them (small global trader), and that was relatively independent, with exception to the participation in the LAFTA (Latin America Free Trade) and, more recently, LAIA (Latin American Integration Association). The option for a deeper agreement with Argentina, Paraguay and Uruguay (Mercosur) was taken only recently.

The fact is that the configuration of the world trade suffered great changes in the last 20 years. New trade agreements and the significant increase in the intra-industrial trade have forced Brazilian policy makers to think about Brazilian strategy with relation to its policy about international trade and specially to think about the possibility of a new strategy: the concentration of its trade relationship within a strong trade block involving all the American continent.

This integration movement can be already observed all over the continent. The creation of NAFTA and Mercosur, the strengthening of the Andean Group, CACM, etc, suggest us that there is a complementarity of

those economies. Another option is to consolidate a trade agreement that could involve all these Latin America trade agreements, because the industrial countries of the region fears the competition from the north American countries (USA and Canada).

Mexico was the first country to assume the costs and gets the revenues of a free trade area with the USA and Canada. Today, Mexican exports to the NAFTA countries corresponds to 87% of its total exports and imports from NAFTA are equivalent to 77% of the total. For the time being, the trade between Brazil and USA has not been severely affected by the preferences given to Mexico. According to Leon , NAFTA will not produce a substantial negative effect on the Brazilian exports - approximately 1% of the total Brazilian exports to USA will be affected. The significant impact will be in specific sectors like tobacco, textiles, shoes and orange juice.

Some researches have been already measured the impact that FTAA would have impose over the Brazilian foreign trade. According to Baumann , the estimates are that the formation of the FTAA would have a more positive effect on the Brazilian exports than on the Brazilian imports. Exports could increase from US\$19 billion (1995) to US\$30 billion, if the conditions that are implicit in his model could be verified. At the same time, the amount imported from the FTAA countries could increase from US\$22 billion (1995) to US\$28 billion, which would eliminate the trade deficit with the region and would even create a surplus of US\$1.5 billion. Still in accordance with this research, the Brazilian export sectors that stand to benefit the most would be iron and steel, vehicles, coffee, tea, industrial machines, shoes, energy generation equipment, textile fibers, orange juice and sugar. The sectors most affected by the increase in imports would be the technological intensive ones. An analysis of these results suggests that the main beneficiaries would be the countries with a sophisticated industry pattern, specially USA and Canada.

Baumann's research also suggests that Brazilian manufactured goods could benefit the most with the FTAA. This result - in conjunction with the well-known evidence that a substantial portion of the manufactured goods exports sector has the USA and the Latin American countries as the most important clients - possibly suggests that a significant portion of the impact of the integration is because of the easier access to the regional Latin consumer markets, but not necessarily to the north American consumer market. In synthesis, the simulations suggests that, from the point of view of the Brazilian exports, the consolidation of a free trade area within Latin America countries is as important as the hemispheric integration (or even more important). In this sense, the consolidation of the South American Free Trade Agreement could be better for Brazilian exporters.

However, we should consider that the formation of the FTAA does not eliminate the possibility of achieving new markets in South America and, moreover, in the North American markets. In addition, Brazilian consumers would buy cheaper and even better quality goods and Brazil could compete with Mexico for direct investments. It should be emphasized that, as already analyzed in the chapter IV of this paper, the American continent block is responsible for almost 50% of all Brazilian trade (imports and exports), so the FTAA could facilitate the access for Brazilian goods in the most important Brazilian markets.

It is important for Brazil to facilitate the trade with more industrialized countries, because this attitude creates a pressure on the modernization and efficiency of the tradable sectors. However, it is necessary to proceed with caution in the negotiations to avoid a very quick economic liberalization, that would jeopardize the performance of some industrial and agricultural sectors. On the other hand, if there is not this competition possibility, the trend is that the tradable sectors will continue to work in a less efficient way, compared to the international pattern.

If FTAA negotiations continue, the rhythm of the trade liberalization is the most important issue to be negotiated by the Brazilian government. The question is that trade liberalization is a complicated problem in Brazil. Sometimes, the willingness of business people to be prepared to the international competition is not enough, because other exogenous factors hinder their company's performance. These are the so called "custo Brasil" (Brazilian cost), that means, the inefficiency of the transport system, the heavy tributary system, the excessive state bureaucracy - all of this make the Brazilian products more expensive.

Brazil has been promoting deep structural reforms with the objective of modernization, that will be crucial to improve the efficiency of the economy as a whole. As it is a process that involves many politic discussions and

agreements, it takes time to see the results.

If we wait for the willingness to change from those sectors that may be negatively affected by the liberalization process, it will take a lot of time to get the changes. One of the bigger advantages of international competition is, obviously, the exposure to the international competition. We will face the winners and the losers - so the liberalization process must be guided in a certain way to avoid the losers and, by consequence, the social costs.

Conclusion

The world trade pattern has been deeply changed and Brazil must adapt to it, as much as is possible. It is becoming increasingly clear that one of the strong trends in the last 10 years is the trade agreements among countries of a given region, like NAFTA, Mercosur, Asian countries and Europe, which is the most successful example.

Brazil has been increasing its foreign trade very quickly, especially in this decade, and the American continent countries have been the responsible for the great portion of this growth. The fact that almost 50% of the total Brazilian trade is actually been made with these countries can't be ignored. Europe is a major partner also, but they are geographically far from Brazil and they basically demand Brazilian primary products. On the contrary, trade with the Latin American neighbors is concentrated in manufactured goods and these countries seem to be more easily integrated because of the complementarity of their economies. Another important factor to be observed is that the USA is a major investor in Brazil and this (the direct investment) is a crucial factor for increasing intra-industrial trade.

Thus, maybe it's time for Brazil to pursue an integration trade agreement with the American continent countries, including USA and Canada, in order to improve its efficient use of resources and to be able to buy cheaper and quality goods from the countries that have advantages over Brazil in those specific product.

The velocity of the implementation is a crucial issue for the Brazilian economy. The government should negotiate a sufficient time for certain Brazilian economic sectors to adapt to the strong competition, specially from USA, Canada and Mexico. In the medium and in the long run, I believe, that everybody will be better than today.

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