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Development through Trade Programme

Trade Reform in Southern Africa: Vision 2014?

Working paper

TRADE POLICY AND REFORM IN BRAZIL

Trade Policy and Reform in Brazil

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Note: This is a working paper. It may not be cited, referenced, or used for further research until such time as it has been published. However, the author welcomes comments, which may be sent to B.Bowen@itsglobal.net.

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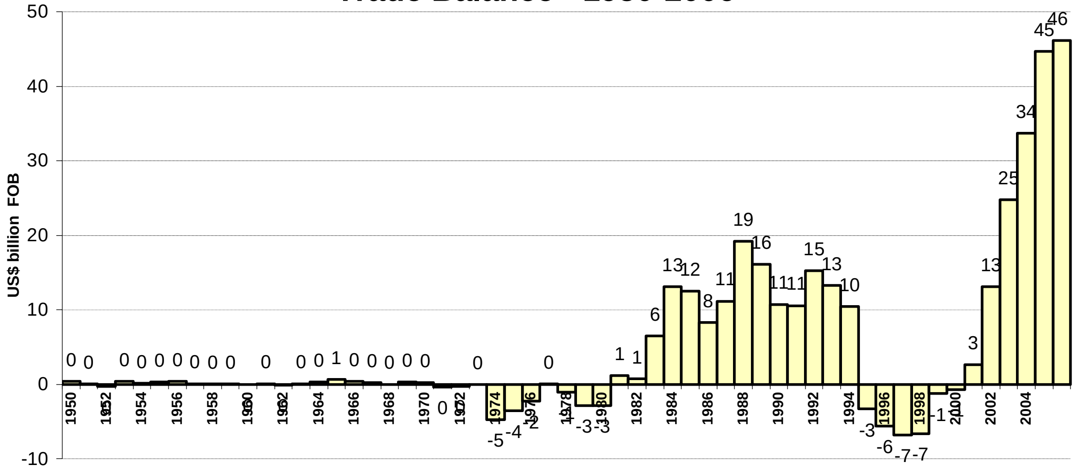
Introduction

This is a paper about trade policy and reform in Brazil – past, present and future. Its main objective is therefore to probe into one of the most crucial areas in Brazil's economic framework with a view to putting it in perspective at a particularly auspicious moment in the country's numbers, indices and stature. World trade has been highly bullish for a number of years and Brazil, alongside many of its competing trade partners, has benefited significantly from it. The question remains, however, whether regulations, policies and institutions can fare well independently from "global winds" – a question which itself begs a number of other questions: has reform occurred, to what extent has it occurred if it has, is additional reform needed and in what respect? Additionally, is Brazil prone to reform or has "self-satisfaction" set in? What are some of the lingering problems and possible solutions?

Good Numbers, good stature

When a country goes from a trade deficit of USD 7 billion to a surplus of more than USD 46 billion in nine years, enthusiasts and critics alike have to agree on the virtuosity of the numbers. When that country is Brazil and the period is 1997-2006, all agree, all the more so. In addition, despite the strength of the Real for more than a year, the trade surplus grew 3,1% in 2006, the first year nevertheless for exports to grow less - or decrease more - than imports since the year 1997. According to data from Brazil's Ministry of Development, Industry

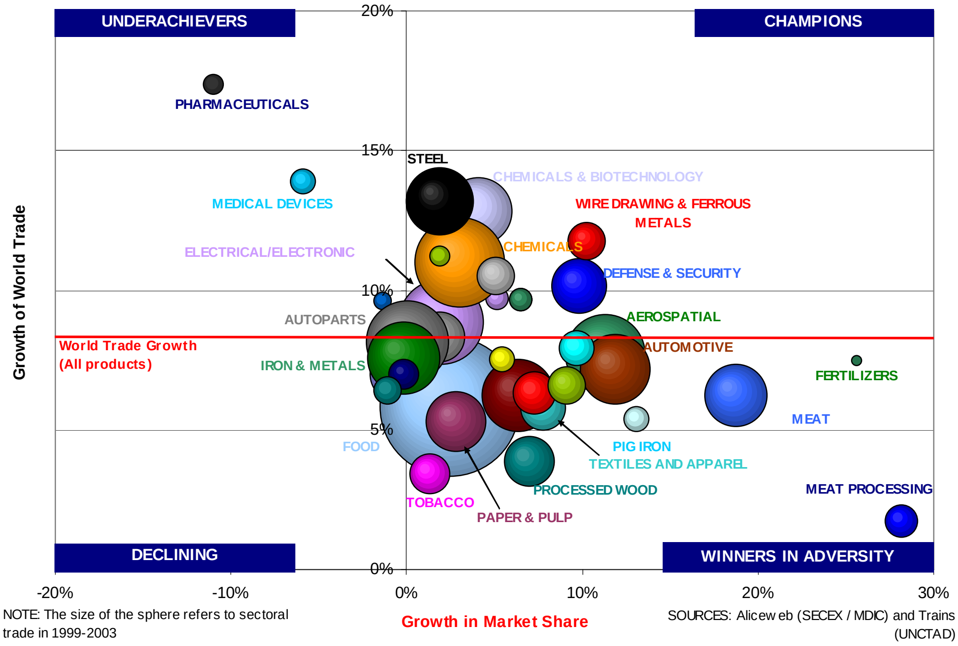
Trade Balance - 1950-2006



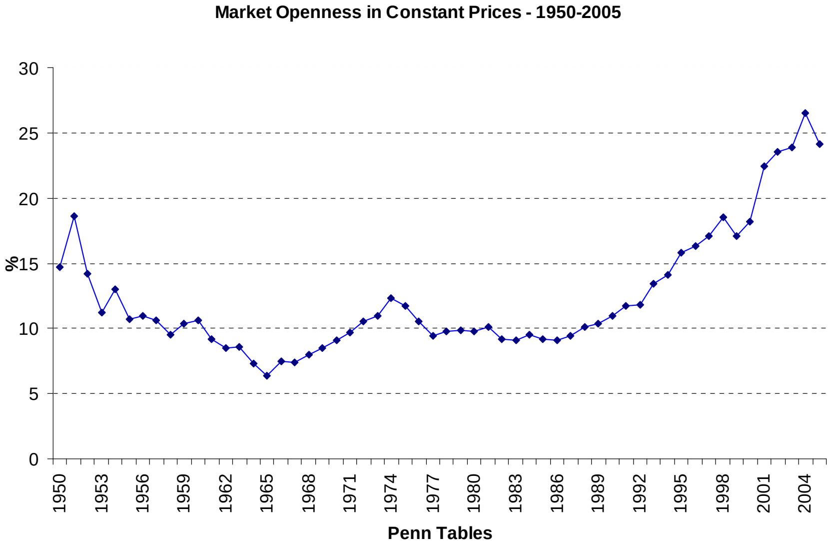
Source: Ministry of Development, Industry and Foreign Trade

and Foreign Trade (MDIC) and from the World Trade Organization (WTO), Brazilian exports have grown close to 17% on average annually since 2000 while the corresponding figure for world exports is only 11%. If the last three years are looked at, the difference is even more revealing: 24% average annual growth for Brazilian exports vs. 17% for world exports.

Further goods news relates to the competitive position of Brazil's industrial sectors – normally perceived as the most risk and competition-averse in the country. Studies have shown that most of the Brazilian industrial sectors have recently (1999-2003) increased their market shares when trade in those sectors has increased both more or less than world trade. In other words, as the graph shows below, most of the Brazilian industrial sectors could be considered either as "champions" (gained market share when world trade in the sector grew more than the world average) or "winners in adversity" (gained market share even when world trade in the sector grew less than the world average). Sectors that normally take defensive positions in trade negotiations such as the chemical or the electrical/electronic sectors have both gained market share, tracking broadly with the better-than-average growth of sector trade in the world – i.e., both should be considered champions. Other defensive sectors, such as the automotive and the textile and apparel, have gained market share despite a lower-than-average growth of global sector trade which puts then in the winner-in-adversity quadrant of the graph. The sheer size of Brazilian trade in certain sectors (size of the spheres in the graph) attests to its dynamism.



The prowess of Brazilian foreign trade is also attested by another important indicator: market openness – i.e., the country's trade flow (both imports and exports) as a share of the country's gross domestic product (GDP). As the figure below shows, it took Brazil almost 50 years to reach levels comparable to those reached in the 1950s; a half-a-century which had its historical lowest point in 1965 and only saw consistent growth after the opening up of the economy in the beginning of the 90s. The highest historical point was reached in 2004 when Brazil's foreign trade was equivalent to more than a quarter of the country's GDP. It has been decreasing ever since, having reached 21.4% in 2006 – still a high number from a historical perspective. According to data from (MDIC), the trade flow itself grew 340% since 1990, 137% since 1995 and 106% since 2000.

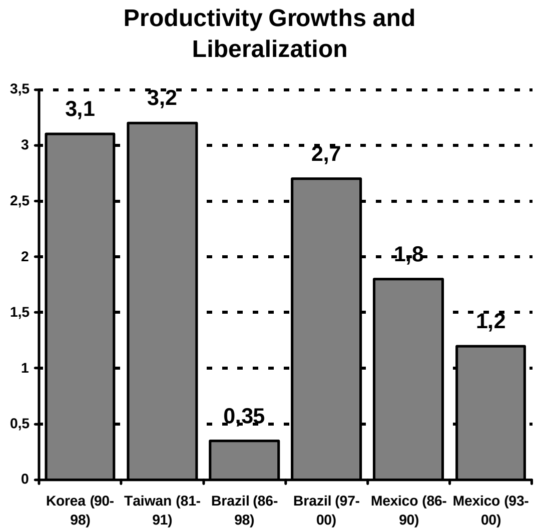


Still on the ullish side, Brazil exhibits a highly diversified partner profile in its trade with the world – a very positive attribute indeed. MDIC official data show that While the U.S. continues to be the most important individual trade partner with 17% of overall trade, the European Union, as a block, accounts for almost one quarter of Brazil's trade (22%). Latin America accounts for another 21% and Asia 19%. In other words, Brazil's trade is almost evenly divided amongst the world's main trading partners. Mercosul, the country's alleged main foreign policy priority, has seen its share slip from around 16% in 1997 to 10% presently. Yet, Argentina has regained its place as second to the United States as an individual partner with almost 9% of Brazil's trade while China has gone back to third with 7.2%.

<u>**Can one criticize?**</u>

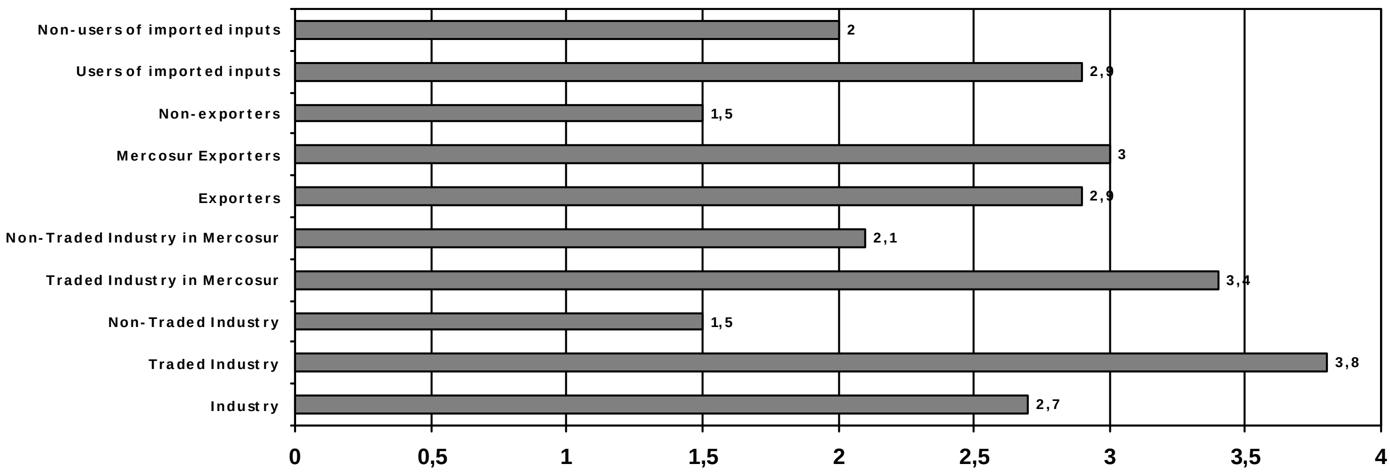
The euphoria prevailing in the minds of Brazilian politicians regarding trade figures brings with it the risk of accommodation and inaction on the part of the public sector. After all, there is no doubt that the positive results one observes nowadays in Brazilian foreign trade have much more to do with the homework that has been done since the mid-nineties and the unusually bullish conditions of the world economy for quite a few years than with any of the policies or strategies undertaken by the current government. In fact, the sluggishness in taking decisions, the confusing regulatory situation in a number of otherwise FDI-led sectors and the lack of crucial reforms in the tax, labor and pension systems could all band together to bury Brazil's chances of consistently entering international markets were it not for the enormous Chinese demand for primary products, its effect on world prices, consistent growth in OECD countries and a considerable liquidity in financial markets.

Studies have shown that the opening up of the Brazilian economy in the 90s stands as a primary reason for the impressive growth in productivity levels in the economy – the foundation of today's competitiveness in a number of important sectors. In comparative terms, the growth of productivity levels in Brazil in the post-liberalization period (1997-2000) were almost as high as those observed in South-East Asian countries such as Korea and Taiwan during their corresponding post-liberalization periods. The contrast with the period previous to liberalization in Brazil was stark indeed: 0,35% vs. 2,7% (Moreira, 2004).



Source: Moreira, Maurício Mesquita, 2004

When looking at the firm level, the evidence shows that those involved in foreign trade were the ones to gain the most in productivity levels. Tradable sectors in industry were the ones to register the biggest productivity growth rates, nearing 4%. Traded industry within Mercosul also had impressive productivity gains at over 3%, as did Mercosul exporters. On the other hand, non-exporters and non-traded industry had the smallest rates of productivity growth – at around 1.5% only. The data therefore shows indisputably the virtuous circular logic of trade in the case of Brazil: sectors that were open to the world benefited the most in terms of productivity growth rates; in turn, with greater productivity gains, these sectors become more and more competitive and thus well-positioned to benefit further from world markets.

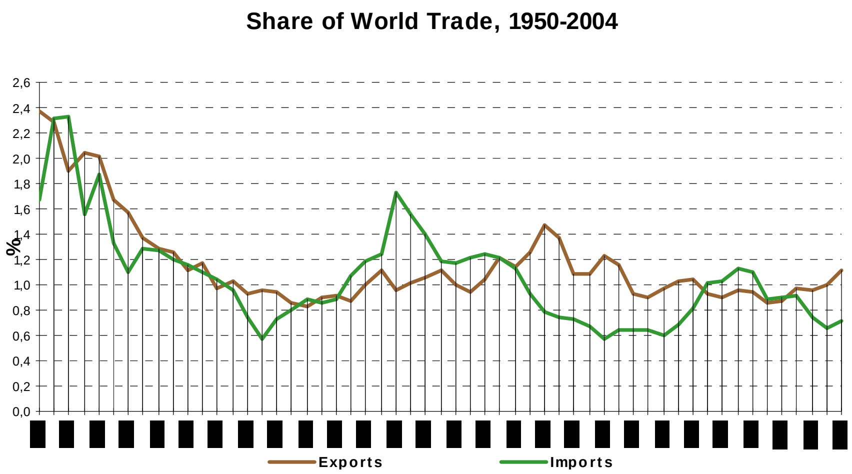


Source: Moreira, Maurício Mesquita, 2004

Economic theory purports that one of the most important linkages between trade and development, particularly industrial development, refers to the effect that cheaper imported inputs, machines and equipment (capital goods) have in the national production and productivity levels. With greater market openness, capital goods tend to lower in prices and thus become more readily available for local producers who can introduce them in their productive processes and obtain a better quality product for a lower cost (De Negri, 2006). In Brazil, the prices of capital goods did indeed track broadly with the opening of the economy where a consistent fall in prices occurred from the beginning of the decade until 1998. Overall, the reduction in capital good prices was of around 47% between 1990 and 2001.

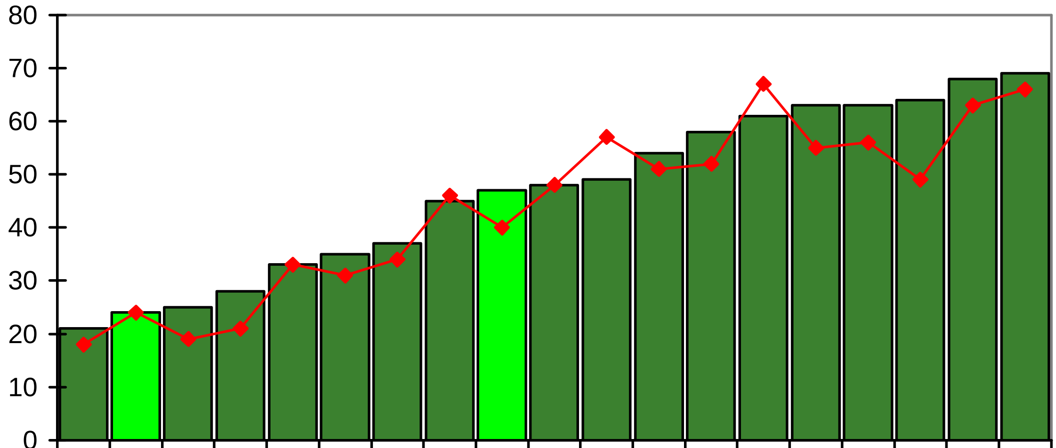
Normally, economic growth holds a negative correlation with capital good prices – i.e., the lower the capital good prices, the higher the growth of the economy. This is achieved, according to economic theory, because the prices of capital goods alongside that of construction are the two main components of the so-called “relative price of investment” which is in turn a crucial input into the economic growth equation. However, studies have revealed that in the case of Brazil, the fall in the relative price of investment was much lower than the fall in the relative price of capital goods in the nineties. From the looks of it, therefore, capital goods have contributed their share to the growth effort but construction has not. An overall fall of only 3% in the price of investment when capital goods prices fell by 47% between 1990 and 2001 demonstrates how absent construction was from the picture.

Despite the bullish numbers, the fact remains that Brazil’s face to the world continues to be smaller than its growing international stature. Brazil continues to account for hardly one percent of world trade (both imports and exports), in a process that lasts already some forty years. Since the sixties, Brazil has oscillated around the 1% mark in both trade directions, after a major slump from the 50s when both exports and imports accounted for over 2% of world trade. There is no doubt that for a country that is amongst the ten biggest economies in the world, 1% of world trade is indeed uncomfortably small.



Another size of smallness is the market openness index. Despite the bullish evolution of the trade flow and the resumption of a level of openness approaching one quarter of GDP in the last few years, the fact remains that in relative terms Brazil lags behind some of its main competitors - the BRICs to start with. Even India, normallseen ay s a fairly closed economy, has overtaken Brazil by four percentage points with a market openness level of 28% in 2005. Russia’s index is twice as large while China’s is 2.7 times larger than Brazil's. Brazil's index sits between the U.S.'s or Japan's, both of which exhibit the world's greatest GDP's. The overall world openness is itself almost twice (1.95) as big as Brazil's. Additionally, Brazil is one of the few "prominent" countries that did not see its market openness increase in the recent booming period of the world economy. As the graph below shows, between 2002 and 2005, the index remained at 24% - in stark contrast with most of the other countries depicted. As we have seen above, it has decreased even further to around 21% in 2006.

Market Openness, 2002 and 2005, current prices



	U.S.	Brz	Jap	Ind	Aus	Col.	Arg	Fra	Wrld	Rus	Saf	Indo.	Mex	Can	Chl	Ger	Chi	Swz	Kor
2005	21	24	25	28	33	35	37	45	47	48	49	54	58	61	63	63	64	68	69
2002	18	24	19	21	33	31	34	46	40	48	57	51	52	67	55	56	49	63	66

Source: The World Bank, WDI Data Query

The most bearish aspect of Brazil's competitiveness is, of course, its relationship to growth. With growing market opening levels, growing productivity levels particularly for sectors that are somehow internationalized, and cheaper capital goods (as a direct effect from the opening up of the economy in the last decade), one would intuitively expect economic growth to follow as well. Yet, this has not happened. Although Brazil is catching up to its main competitors, economic growth is still too low for the country. As mentioned before, part of the explanation refers to the price of construction which did not follow the price of capital goods in its downward trend. This, however, cannot exhaust all the reasons for economic sluggishness in Brazil.

Looking Back

Industrial policy and protectionism have always been an important part of Brazilian economic life - even if to varying degrees in time. In the post-World War II period, Brazil pursued a very protectionist industrialization, substituting imports via very high barriers and strong investment incentives. As from the seventies, that recipe would also include export promotion through various fiscal and financing incentives. Things would not begin to change until the mid-eighties and beginning of the nineties.

One could say that trade policy in those days was the result of a particular type of domestic focus – that of an industrial policy which required protection from imports and heavy domestic and export subsidies – however defined. In that sense, it constituted something to be *administered* and not *formulated*, requiring as such a strong entity that could take on the administration. That entity existed and had the particularity, never "restored" ever since, of congregating all of the trade-related matters under one single umbrella: operational and regulatory functions, trade financing, subsidies, export promotion, import "control" and even some trading of its own. It was called the *Carteira de Comércio Exterior do Banco do Brasil* (CACEX). The unilateralism of CACEX tracked broadly with the authoritarian government that had invented it. All decisions were centralized there with a very low degree of transparency, and the contact with the private sector, albeit to some extent organized along sectoral lines, was highly informal and unpredictable.

Trade negotiations were not a major factor in trade policy up until the mid-eighties. The CACEX period in large measure coincided with the negotiation of the ALADI (LAIA – Latin American Integration Association) agreements which, as the organization of CACEX itself, were sectoral in nature and very limited in depth and scope of market opening commitments. Clearly, these agreements did not command much "policy weight" and did not pose any real threat to the prevailing import-substitution model of the time. As a consequence, one could safely assume that the role of foreign policy and the Ministry of External Relations were also fairly scant in trade policy for the period, as most of the decisions were concentrated in one place and focused on domestic instruments and policies.

Changes in trade policy began to become inevitable already in the late 70s as the overall import substitution system gave signs of exhaustion as a vehicle of economic growth. The country had gone through two major oil crises with a consequent substantial reduction in public savings – from close to 8% of GDP in the beginning of the 70s to close to zero in 1983-85. During the first years of the 80s, Brazil would go through a major recession and the part of imports in the apparent consumption would decline consistently due to the devaluation of the exchange rate and import controls applied also in the beginning of the decade. Even in the most internationalized sectors, imports did not top 15.7% of national apparent consumption.

With recession and low public savings, the pressure to cut investments and subsidies increased. With the second oil shock in 1978-79, inflation would spiral, reaching 100% annually already in 1979 and climbing during the 80s to the 2,000% level by 1990. As Abreu (2007) puts it, economic stagnation alone could not explain why the 90s were inaugurated with a new trade policy. The stagnation could explain at most why the first democratic election after 30 years would be won by an unknown political figure, from the Northeast of the country, whose mark was a strong anti-establishment speech – whether in political (anti-military) or economic (anti-elite) terms. It was the vision of Mr. Collor de Mello himself that would explain the radical changes in trade policy but, ironically, not only for trade's sake: Mr. de Mello's speech was against governmental intervention *tout court*, of which trade policy was merely a particularity.

Trade liberalization in Brazil took place in three bouts of tariff reductions. The first one was in 1988-89, even before the election of Collor de Mello, when the nominal average tariff fell from 57.5% to 32.1% - a decrease of fully 44%. The aim here was to do away with redundancies in the tariff structure. The second bout of liberalization took place in 1991-93, with a bout of pro-trade measures, including a unilateral reduction of barriers to imports (tariff and non-tariff), the extinction of CACEX – the icon of Brazil's import-substitution period – and the search for a new approach to trade and integration in the Southern Cone of the Americas. Tariffs were reduced in this period to a nominal average of 13.5%. The third bout of liberalization took place in 1994 alongside the launching of the anti-inflation stabilization plan, the "Real Plan", and as a support towards the plan's aim to keep domestic prices under control. The nominal average tariff would decline to 11.2%.

By the time Fernando Henrique Cardoso came into office in 1995, Brazil was already on the path of a very different trade policy apparatus and *modus operandi* which together would contribute to a correspondingly different orientation as well. The first noteworthy change was, therefore, the immediate division of labor that emerged among different ministries. The brunt of operations and related regulation remained in the Ministry of Trade and Industry (nowadays, Ministry of Development, Industry and Foreign Trade), with the exception of some customs matters such as tariff revenues and customs valuation. As to the new "generation" of agreements spearheaded by Mercosur itself, the lead-ministry was to be External Relations. Even though the internal process would therefore become more democratic, the government's relationship to the outside would start on a wrong footing: the private sector still complains today about how in the beginning of the nineties they were not consulted on the unilateral or the sub-regional (Mercosur) market opening initiatives undertaken at the time. As to being democratic within the government, by 1995 a *Câmara de Comércio Exterior* (Board of Foreign Trade – CAMEX) would be created with a view to correcting the perceived lack of coordination among ministries and agencies involved in trade policy. Many believe that institutional coordination still has not been satisfactorily resolved.

The launching of the *Plano Real* in 1994 would reinforce the free market orientation of the beginning of the decade. Brazil would spearhead the "deepening" of Mercosur by putting its weight on the passing of the Ouro Preto Protocol – the instrument which formally gave the block the roadmap to a full-fledged Customs Union. The Ministry of Finance, the government's strongest in the new Cardoso government, would favor policies that at a minimum did not increase import prices and continued therefore on the path of greater competition and contestability in the domestic market. Tariffs would continue to fall according to Mercosur's schedule for the Common External Tariff (CET) and the implementation of the agreements of the newly-founded World Trade Organization (WTO) would also provide for some liberalization.

It should be noted that, albeit the rhetoric and a generally favorable bias, not much liberalization effectively took place in the second half of the nineties – or ever since, for that matter. There was market opening in the period but it was not trade-driven. The privatization program, and not trade policy, was the dramatic market opener towards the end of the decade.[2]

The year of *Plano Real* was, of course, also the year of the Miami Summit and the launching of the FTAA negotiations. The advent of the hemispheric negotiations was perhaps the single most important influence on Brazilian trade policy in the decade. Thanks to that initiative, Brazil underwent an internal restructuring of the government, alongside an equally impressive reshaping of its relationship to trade policy stakeholders.

It is true that since the Treaty of Asunción in 1991 that launched Mercosur (as a common market plan), Brazil had already left behind ALADI practices and embarked on pro-trade and wider-than-trade initiatives that went beyond border measures and import-related restrictions on goods, to encompass domestic policies and trade and investment in services. The Treaty of Asunción itself called for the free movement of goods, services and factors of production – a clear departure from anything ever seen in the Southern Cone until then. It is also true, however, that the extension of the concept of "trade" to matters relating to services, investment and intellectual property, for example, did not dawn on Brazil's trade establishment until a full-fledged NAFTA-like agreement was proposed for all of the Americas by no one other than the United States. Proof of that is that Mercosur has still not been able to put into force two investment protocols members agreed to over ten years ago.[3]

It would be fair to say that the FTAA has made trade negotiations the most important item in Brazil's trade policy for over ten years now. Thanks to it, a number of adjustments and redefinitions occurred in the country's trade regime which might not have occurred in its absence. Thus, trade, which had been shared as a policy among primarily three ministries and the Central Bank, would now attract a number of other ministries and agencies within the government as the scope of issues negotiated had grown considerably. Concomitantly, many private interests and social groups that had been absent from the trade establishment, were now willing and (somewhat) able to participate. The Government would react to this by organizing itself as well as it could to respond to negotiating demands while involving society in position-building exercises of various sorts.

[2] Additionally, the debate within the Cardoso government itself would ultimately put a damper on further liberalization efforts: "developmentalists" would pit themselves against "stabilizers" and neutralize any unilateral impetus to further open the economy to foreign competition. The polarization was both erroneous and erratic at the same time. The basic premise of the divergence in outlook was that those that were in favor of the stabilization of the economy were somehow against "development" while those that were in favor of development were somehow against a stable economy – a very curious and self-defeating dichotomy indeed. The debate centered on levels of exchange and interest rates, as well as the trade-off between macro (read, further liberalization) and microeconomic (read, industrial interventionism) policies.

[3] The Colônia Protocol, signed on 17 January 1994, deals with intra-zone investment while the Buenos Aires Protocol, signed on 5 August 1994, deals with extra-zone investment.

Foreign trade policy in Brazil in 2005 has almost become fully equivalent to "foreign trade *negotiation* policy". The initial FTAA-driven phenomenon has broadened itself to include other negotiating phenomena such as Mercosur-European Union or the myriad of bilateral 4+1 agreements currently agreed or under negotiation. Alongside a strong emphasis on export promotion, particularly since devaluation in 1999, the central place that the complex realm of international trade negotiations has come to occupy in Brazilian trade policy is undeniable.

When Luiz Inácio Lula da Silva became presidential candidate for the fourth time, his opposition to a FTAA was widely known, tracking broadly with the wishes of his own party, the PT. During his last campaign, however, things would change dramatically. He would distance himself from a plebiscite on the FTAA sponsored by Brazil's main workers' union, CUT, and ably change his adamant opposition to an agreement to a conditional willingness to negotiate it. When he took office, he maintained that stance, having also invited to his administration economic and sectoral ministers that could turn that stance into practice (finance, development/industry/trade, and agriculture). It has been common knowledge that in the Ministry actually in charge of the negotiations, External Relations, President Lula was agreeable to integrating high level officials that had been firmly opposed to the FTAA, in both the written and spoken media.[4]

When Lula's government started, therefore, experts knew that trade policy, especially of the sort that related so significantly to trade agreements in general and the FTAA in particular, was to undergo change in Brazil – even if the full extent of that change would take some time to run its course. A defining moment took place in the run-up period to the Miami Ministerial of the Summit of the Americas process in November 2003 when President Lula found necessary to call in the different ministries involved in trade policy and inform them that trade negotiations – FTAA and others - and matters directly related to them were to be headed by the Ministry of External Relations – effectively bringing that ministry back to the center of trade-policy making in Brazil. By doing so, the President expected to end whatever power struggle might be occurring within the government while making clear to society who called the shots on the FTAA and related trade matters. Many then perceived, both internally and externally, that the government had opted for hardening its position in the FTAA negotiations.

The year of 2004 was a very busy one for Brazil's trade policy. While the WTO's Doha Round, the FTAA and the Mercosur-European Union negotiations all failed to meet their deadline, Brazil pushed forward with a number of initiatives, both autonomously as well as *via* Mercosur. Agreements with the Andean Countries, India and South Africa were concluded and a South American Community of Nations was set up.[5] The India-Brazil-South Africa (IBSA) Initiative also moved on and ministers met in March 2004 to set down the "New

[4] "*Amorim indica secretário avesso à Alca" in Folha de São Paulo, 2 January 2003.*

[5] The agreements between Mercosur and Índia and South África have been signed but are not yet in force. The agreement with South Africa, for example, has been signed before the negotiations were effectively completed (as of October 2007, they are still incomplete)

Delhi Plan of Action". There is no doubt that the foreign policy aspect of trade is highly engaged, with Brazil thrusting ahead primarily with countries from the South, including, of course, its own region – even if in the absence of palpable concrete economic gains. All South-South agreements pursued by Brazil were preferential trade agreements (PTAs) and not of the free trade type (the FTAs). A limited number of items (little over 1,000 with South Africa, for example, out of 11,000 plus possibilities) were negotiated under PTAs for which preferences, and not full elimination, were granted.

The question that has arisen in the national debate centers on whether trade has "the right" to be so foreign-policy-driven. The perception has formed in many quarters that if there is any economic policy influencing the trading game, it has much to do with the government's renewal of Brazil's traditional predilection for autonomous industrialization and policy-making: international agreements must not do away with the "policy space" necessary for the country to pursue its self-defined development. There are strong differences of opinion regarding these issues and the government entered its third year under considerable attack from the private sector for the perceived heavy-handed way it has dealt with both the issues as well as their fall-out. The implications for trade-policy-making could hardly be more direct.[6]

Negotiating forward

The fact that Brazil has become a leader on a number of trade fronts is good news. At the WTO, the G20 involvement alongside a very pro-active approach to dispute settlement panels where the country has taken on the U.S. on cotton and the E.U. on sugar in addition to a number of other less conspicuous cases surely adds to Brazil's outright protagonist role within the organization. Regionally, Brazil has led Mercosul both internally and externally, having managed many a crisis and engaged the block on a full host of negotiations with partners around the world. In addition to association agreements with Chile, Bolivia and the Andean countries, Brazil spearheaded the creation of the South American Community of Nations at the end of 2004. Outside the region, Brazil launched a trilateral initiative with India and South Africa (IBSA) in 2003 which served as a complement to the above mentioned Mercosul agreements with those countries (SACU in the case of South Africa). The good news here is that Brazil is somehow in touch with partners around the world.

There has been a lot of criticism, however, on the perceived encroachment of geopolitics into the trade policy realm. The private sector, the main interested party in trade matters, has been highly critical of the government's approach to trade agreements. Not only there is a lingering impression that the government is slow on agreements with Brazil's main trading partners that together account for half of the country's trade – the U.S. and the E.U., but there is also strong evidence that the government is willing to pay "trading prices" for geopolitical matters of its interest. Thus, agreements with the likes of India or South Africa,

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[6] *"Amorim nega lentidão do Itamaraty em negociações comerciais" in Valor Econômico, 2 December 2004.*

despite not making much sense for a country that fears competition from FTAA partners, fulfill other non-trade objectives – the most prominent of which is, of course, the search for a seat at the United Nations Security Council. Via Mercosur, it has agreed with the Andean Community to long phasing-out schedules and avoided talking about anything beyond goods. Mercosul has been constantly negotiating with distant and unusual partners such as Morocco, Egypt and the Gulf Cooperation Council but always with a view to very modest agreements that hardly go beyond mere fixed preferences for a limited number of agreed goods. The private sector, once again, does not find it amusing whatsoever to see their markets being exchanged for distant geopolitical aims – particularly when they are scarcely consulted about such agreements or such objectives.[7] With China, the most delicate case around for the whole world, Brazil has pretended to have a "strategic alliance" despite various Chinese signs to the contrary.[8]

Where to?

The most negative aspect to reckon with in Brazil's trade universe is the so-called "Brazil Cost" – a hodge-podge of doing-business and doing-trade obstacles that plague the country's overall trade and investment regime. According to the World Bank[9], there are 27 dates a year that a normal Brazilian citizen or entrepreneur has to remember for tax reasons. Doing taxes may take up to 2600 hours a year – another world record, against 87 hours in Norway. There are more than 15 procedures in order to open up a firm in Brazil while in Australia one can do it almost instantly, by internet. Even more serious is the infrastructure deficit. Expert estimates put the minimal necessary investment in infrastructure, necessary to bring it to a global average state of affairs, at at least US$ 12 billion a year.[10] The country has been getting only half of that because the regulatory environment has not yet been clearly defined after a few years of back-and-forth oscillation between Congress and the Administration.[11]

A very common perception in the country is that successive governments have delivered on *macro*economics but fallen disastrously short of addressing *micro*economics. The necessary regulatory overhaul and revamp has not taken place, nor have the main restructuring reforms of the pension, tax and labor systems – all of which account for one of the highest burdens on trade and investment in the world. Brazil's tax burden is at Swedish levels. Brazil's

[7] Even within South America, the approach to agreements has been highly questionable to both analysts and industrialists.
[8] Only a few days after a State Visit to Beijing by President Lula, Chinese authorities stopped a shipment of Brazilian soy beans in the middle of the China Seas on account of alleged contamination. Both countries have been at this issue ever since. In the meantime, however, the Lula government has conceded market economy status to Beijing and hesitated for as long as it could on the application of special safeguards against Chinese imports as *per* China's Protocol of Accession to the WTO. The private sector has openly criticized the government for its leniency with Beijing on trade matters.
[9] See the "Doing Business Survey" in www.doingbusiness.org.
[10] Brazilian Association of Infrastructure Development, ABDIB at www.abdib.com.br
[11] The problem here has been the government's "Public Private Partnerships" which have been rejected by Congress a few times under pressure from the private sector for its original interventionist character. A little more detail on this would be interesting.

infrastructure is far from Nordic standards, however. To top it all off, Brazil's interest rates have been consistently the highest in the world. In 2005-2006, the appreciation of the Brazilian currency, the Real, vis-à-vis the U.S. dollar has been the greatest in the world as well. Brazilian exports have felt the brunt of it. Entrepreneurs have yelled and screamed accordingly.

Brazil's trade is moving forward in the absence of trade agreements. In the last ten years, there has been no significant agreement whatsoever negotiated, ratified and applied that has effectively resulted in increased trade flows – with the possible exception of a Brazil-Mexico agreement on a number of automotive items which did indeed increase Brazil's related exports to Mexico in a short period of time.[12] Despite bullish markets and numbers, Brazil needs to continue on the path of increased integration with the world economy and may not yet have the conditions to do so due to a significant array of self-imposed barriers. A lot of homework is in order, including a reconsideration of trade policy, trade agreements and, ultimately, trade liberalization. The problem is political but it would be unfair to characterize those in opposition to further market opening as mere protectionists.

There may not be any entrepreneurial class in the world that would welcome further market openings in the presence of the conditions faced by Brazilian producers *in their own market*. The Brazilian private sector may be less adverse to further liberalization than it is to the apparent perpetuation of the so-called "Brazil Cost". There is a consensus on what needs to be corrected and on the urgency of the matter. However, successive governments have failed to act, dangerously allowing the country to be overtaken by a number of important competitors in the world. Observers overseas should look for the internal trade-off when trying to understand Brazil's positions in international fora. Increasingly, Brazil's producers will link international initiatives with domestic commitments on the part of government. The average applied tariff for industrial products in Brazil is as low as 10.5%, with items such as chemicals and capital goods having tariffs close to zero in many cases. The problem is not there but on how fast may government deliver on a trade and investment regime that approaches a level playing field vis-à-vis a much less burdened outside world.

The Procedure[13]

Brazil has an established procedure for consultation on trade policy issues – particularly insofar as trade negotiations are concerned. This procedure takes place within a structure that dates back to the first Cardoso government – once again, at the time of the launching of the FTAA negotiations. Up until then, a different, less structured, more informal and more sectoral system of

[12] Brazil has two "Economic Complementation Agreements" with Mexico: the ECA 53 which applies fixed preferences to around 1,300 products signed on July 2003 and the ECA 55 which applies only to the automotive sector. Sixty percent of Brazilian exports to Mexico are automotive. Of an annual surplus of over US$ 3 billion, half can be directly traced to the ECA 55 agreement.

[13] This section borrows from a similar section of the paper "Trade Policy-Making in Brazil" by the author for a joint project of the Interamerican Development Bank, the Munk Center at the University of Toronto and the Interamerican Dialogue.

consultation was in place, as it had evolved away from the eighties when CACEX dominated the full spectrum of trade issues and ALADI negotiations. The system of the first half of the nineties, after a lull in the first years, would once again be sectoral in nature, but much broader in its participation, including for the first time labor unions and other civil society groups. It would trail broadly the thematic structure of Mercosur sub-groups, having been at its highest point in the decade at the time of the Common External Tariff (CET) negotiations.

The launching of the FTAA negotiations changed the system in a number of important ways.

- First of all, the focus on "traditional" trade, only involving the movement of goods, would soon be substituted by a much broader scope of themes based on the then recently-agreed NAFTA, thus "forcing" coordination on both domestic and international matters.

- Secondly, a number of government ministries and agencies that had never had an inter-facing issue with those negotiated in trade agreements suddenly were called to participate, inform the discussion and take a position on matters which were, in addition, no longer "trade-related" in the old conception of the term.

- Thirdly, a myriad of civil society groups that had never given much priority to trade negotiations, were suddenly highly interested in participating and reserving their positions on an agreement widely perceived as ambitious and demanding; the fact that the United States was the main protagonist was, of course, not taken lightly by any potential stakeholder.

- Fourthly, in addition to its own internal organization, the government had to organize its dialogue with the private sector and other stakeholders. The Ministry of External Relations thus created the *Secretaria Nacional da ALCA – SENALCA* (National FTAA Secretariat) with the attribution of congregating representatives from other ministries and government agencies, as well as *guests* from civil society.

- Fifthly, in addition to the umbrella SENALCA, the government would create thematic groups around negotiating issues – also a first in Brazil's trade policy.

The FTAA was therefore the ground-breaking motivation for Brazil to revamp and overhaul the manner it went about trade-policy-making. Since then, a similar construct has been put into place for the Mercosur-European Union negotiations – SENEUROPA, and for WTO-related matters – *the Grupo Interministerial de Trabalho sobre Comércio Internacional de Mercadorias e Serviços* (GICI). Mercosur has its own formal consultative process, undertaken by the *Fóro Consultivo Econômico e Social* (Economic and Social Consultative Forum).

The system that exists today for consultations is a result of this FTAA-driven process and some of the changes introduced along the way – particularly since the beginning of the Lula Government. The main characteristics of the current system can therefore be summarized as follows:

- Agenda. The agenda for the consultations is set by government representatives – namely, coordinators from the Ministry of External Relations. It is largely determined by the priorities of the negotiations, as defined by the Ministry itself. In the broad fora such as GICI, SENALCA or SENEUROPA, the agenda tends to focus on informing what has been taking place in the negotiations.

- Strategy. Strategic matters are usually fully absent from the consultations. This has been "aggravated" in a sense because of the perceived emphasis by the Government on geopolitical arrangements – i.e., arrangements that are guided by political tenets as opposed to commercial interests. The fact that the government has been deciding "by itself" the underlying motivation for concluding trade agreements has been highly resented by the private sector which has been very explicit about the lack of economic basis for some of the decisions taken.

- Transparency. By the time the system expanded to include much more than trade in goods *per se* and that civil society began to be involved beyond the directly interested private sector, a gain in transparency was clearly at hand. To go beyond a general FTAA grouping to include thematic sub-groups and later to branch off into other negotiations (Mercosur-E.U.) was also a positive move towards greater transparency.[14]

  - However, the current government has not consulted much on the thematic, technical level, preferring to focus on the broad, general groupings in an effort which goes some way in legitimizing its positions but falls very short of a proper consultation on all the merits of any issue;

  - Stakeholders are often uninformed about how the government goes about formulating positions and at times are called in at the very last minute to lend support to them anyway;

  - The process continues to be transparent only for those that are closer to the position-building process. In the present government, the non-business sectors have an advantage because they tend to converge with the government on its trade negotiation strategy;

Conclusion: Ten elements to consider

There is no doubt that the Brazilian trade regime has evolved since the advent of liberalization. The problem is that since the opening up of the economy, and with the possible exception of the Collor de Mello government, there has been

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[14] *See, NETTO, Evaristo Machado. "Pela transparência na Alca", in O Estado de São Paulo, 11 December 2003, p. G2.*

no consistent strategic plan for the trade regime as such and changes seem simply to come out of reaction to developments in the world trading system – as opposed to a clear view of where the country wants to be "when its trade grows up". It would be a fallacy to relate the bullish moment of Brazilian figures to significant institutional changes since the beginning of the 90s: the regime remains essentially the same while the world has changed significantly – particularly in the wake of an unprecedented economic prosperity.

In what follows, ten elements are reviewed which underlie the insufficiencies of the current Brazilian trade regime.

1. Bureaucracy

The World Bank has produced a number of "Doing Business" indices which reflect the ease or difficulty in trading in a country. The numbers here are also surprisingly negative. The ease for exporting or importing in terms of number of days required for each transaction is the worst amongst the BRICSAM with more than 40 days for a full import transaction and almost 40 days for a full export transaction. On the importing side, Brazil is akin to India while on the exporting side it is by far the worst. An export transaction takes less than 20 days in Mexico, for example. These numbers are clearly indicative of the high opportunity cost Brazil is paying due to a still archaic trade regime where, apparently, bureaucracy and institutional inertia prevail over pragmatism and transparency.

2. Personalities

The system still relies too much on personalities. Recently, when former Minister Furlan was about to leave, there was a clear element of insecurity in the Brazilian trading establishment as to who the next Minister might be. To some extent, that is natural and happens in any country – even in the most mature democracies around the world. The problem here is in the degree – not in the concept. In other words, the degree to which people express their fear of the unknown should, in trade policy, be mitigated by the strength of existing institutions. In fact, even in trade policy, strong institutions should ensure sufficient predictability *regardless of Ministerial changes*. Brazil is quickly getting there but there still are problems. Additionally, although under a presidential regime, the ministerial make-up of the country is defined according to "Parliamentarian" standards (for many reasons, all beyond the scope of the present study) – *via* government coalitions – which only aggravates the run-of-the-mil fear of the unknown on the part of anyone involved in Brazil's foreign trade.

3. Organization

Once again, this is not a particularity of the Brazilian government but problems exist in the quality of the institutions, the way they coordinate amongst themselves, the ultimate efficiency of the decision-making process. Trade policy in Brazil continues to be spread all over the "Esplanada dos MInistérios" (The Plaza of the Ministries) – i.e., many ministries have a say in trade policy while a few, more than one certainly, command it. Having many ministries and agencies dealing with trade policy is, in large measure, "natural". Having problems in the ultimate command of trade policy is a problem. Brazil has a Board of Foreign Trade which has the attribution of coordinating and ultimately taking decisions. This still requires refinement as Ministries at times decide for themselves how to proceed on particular issues. Trade negotiations, in particular, give rise to a great deal of conflicting signals and policies. Decisions on positions to take in negotiations can be "unilaterally" decided by the Ministry of External Relations irregardless of the Ministry of Development, Industry and Foreign Trade may consider on a particular issue. Since the negotiators are career diplomats and not fonctionnaires from the Ministry formally in charge of trade, conflicts are bound to exist. The issue of taking trade away from the Brazilian diplomacy was an issue prior to the election of President Lula. Nowadays, most of the work should focus on better coordination and clear lines of command over the various subjects under negotiation.

4. Consultation

Governments need to consult when it comes to trade policy. The interested parties, increasingly, are not merely the entrepreneurial class but also representatives from various segments of society – a clear reflection of how multi-faceted trade has gotten to be. This is still a problem in Brazil, having perhaps even gotten a little worse under the present government. Consultations should occur under a formal, predictable and accountable regime, *via* consultative groups comprised of representative persons or institutions. In Brazil, this system is still *ad hoc*. The private sector and interested segments of society need to have a *locus* where they express their views – and that should not be limited to individual meetings with Ministers and officials.

5. Strategy

Much of what is happening in Brazil's foreign trade is the result of developments and not planning. In other words, albeit bullish, the country did not plan for it. This works when the world economy is growing and conditions are promising but what to say of the opposite. The country needs more strategic planning, projecting its trade into the future and on the basis of that drafting clear policies for the various possible scenarios. Reacting to developments is a necessity but should not be the only *modus operandi*. In addition, strategies should be made known to interested parties. Brazil has no green or white papers whereby policies are presented in a concise, structured fashion for comments by interested parties. Strategy therefore goes hand in hand with the need to have quality consultation. In fact, consultation must be a part of a good strategy.

6. Policy

Trade continues to be a residual policy which somehow does not figure as prominently as it should under Brazil's so-called "economic policy". Since the days of the debt crises, economic policy has a strong financial emphasis with the Ministry of Finance strongly at the helm. Trade comes into that picture as an incidental item which has to deliver good numbers for macroeconomic reasons – which is fine but does not do justice to trade in all its details. That is, of course, the attribution of the Ministry of Development, Industry and Foreign Trade, but in practice the two ministries seem worlds apart. In a nutshell, while the Ministry of Finance is in favor of liberalization, the Ministry of Development is viewed as the operational arm of bureaucratic protectionism. A practical example of that type of conflict was provided in 2006 when a document was leaked from the Ministry of Finance in favor of a Swiss Formula 15 in the NAMA negotiations at the WTO when the official position supported by the Ministry of Development (and External Trade in that context) had been Swiss 30 (roughly two times less tariff cutting). This sort of problem should be resolved also *via* better organization, coordination and, ultimately, transparency.

7. Orientation

Brazil, as a big domestic economy, is not naturally inclined towards the opening of its market to competitors. It has been doing so anyway but one can hardly visualize any further efforts in that area. The fact is the country only opened its market when governed by a very special President who had grandiose ideas and very quickly was impeached for irregularities in his short-lives government – Mr. Collor de Mello. Had it not been for his personality and personable style, it is safe to assume that Brazil might have not opened its market until today. The proof of that is in that neither the Cardoso nor the current Lula government pursued any liberalization. In fact, since 1995 there has been a backlash in liberalization – albeit "incidental", as a result of various global financial crises that forced the country to look more closely at its balance of payments fundamentals. Thus, between … the nominal average tariff went from …… Curiously, there is not much of a consensus in the country regarding trade policy but "developmentalists" do agree with "neo-liberals" in one thing at least: that the country should only offer any more of its market if in the presence of a negotiation where mutual concessions can be demanded and extracted from trading partners. It is a common perception on all sides of the trade spectrum that Brazil opened itself up without demanding anything in exchange for its "efforts".

8. Geopolitics

It is undeniable that trade policy is closely related to – if not a subset of - foreign policy. Trading with countries may involve choices amongst countries and trade relations, the more they grow, can easily give rise to disputes between the two sides of a particular commerce. International agreements, starting with the WTO itself, aim to "sterilize" the politics out of trade by setting rules, principles and a dispute settlement system for when these are not respected (or are viewed that way by a member country). Yet, the fact remains that countries may seek agreements or pursue what they perceive as trade policy in a fashion which is highly influenced by political aims and objectives. The best one can hope for is that whenever countries introduce much politics in their trade equation that they do so while keeping in perspective commercial risks and opportunities. In Brazil, this has been happening less and less. The country is actually confusing trade with geopolitics as attested by the types of agreements it has been negotiating: agreements with very little commercial ambition but involving partners that somehow can serve a political interest. Agreements such as the ones negotiated between Mercosur and India or South Africa, for example, do not seem to aim at free trade, given the limited and unambitious nature of the commitments undertaken.

9. Evaluation

The trade policy regime of a country must be constantly evaluated as to its functioning and the attainment of set objectives. This evaluation should be unbiased, empirical and involve interested parties who should be able to contribute with their views and experiences. A regular system of reporting the results of such evaluations should also be in order so as to provide predictability in the way governments handle their trade policy. The parameters of the evaluation should be clear from the outset with a view to securing legitimacy in the exercise. Brazil does not have such a system yet. Evaluations are done in an irregular fashion, much at the whims of the authorities who pick what and when to evaluate and reveal results. A predictable, regular and transparent system of evaluation should do much to improve the Brazilian trade regime.

10. Bias

Brazil likes to look at its own belly-button. If left to its own whims, the country will not seek liberalization since it does not seem to see the value of it amongst all the other priorities. In other words, in the absence of a push – such as the external trade negotiations, for example – Brazil is likely to continue on its path of adaptative commercial diplomacy, either seeking out unambitious agreements with good political partners or simply playing dead when ambitious proposals emerge – such as a Free Trade Agreement of the Americas (the FTAA). This belly-button approach is clearly anachronic given the approach taken by many a competitor of Brazil's. The present government clearly needs to be convinced of the merit of anything beyond the elimination of agricultural tariffs and/or subsidies. This has to change, anchored on a full-fledge world view and a prospective appreciation of risks and opportunities in the not-so-distant future.