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Brazilian Trade Policy and the United States

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J. F. Hornbeck
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

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Summary

As the largest and one of the most influential countries in Latin America, Brazil has emerged as a leading voice for developing countries in setting regional and multilateral trade agendas. The United States and Brazil have cultivated a constructive relationship in pursuit of their respective efforts to promote trade liberalization, including attempting to broker a compromise with the European Union in the World Trade Organization (WTO) Doha Round and forming bilateral working groups on trade (and other) issues. Still, they approach trade policy quite differently, are at odds over how to proceed regionally with the Free Trade Area of the Americas (FTAA), and share concerns over specific trade policies and practices.

Brazil's trade strategy can be explained only in part by economic incentives. Its "trade preferences" also reflect deeply embedded macroeconomic, industrial, and foreign policies. Whereas U.S. trade strategy emphasizes the negotiation of comprehensive trade agreements on multiple fronts, Brazil is focused primarily on market access issues as they pertain to its economic dominance in South America. Brazil exercises this priority in all trade arenas, such as pursuing changes to agricultural policies in the WTO, expanding the Southern Common Market (Mercosul) in South America, and resisting the FTAA for lack of a balance conducive to Brazilian interests.

Brazil has a modern, diversified economy in which services account for 53% of GDP, followed by industry and manufacturing at 37%, and agriculture at 9%. Agribusiness (commodity and processed goods) account for some 30% of GDP, explaining Brazil's emphasis on agricultural policies in trade negotiations. Brazil is the world's largest producer of sugar cane, oranges, and coffee, and the second largest of soybean, beef, poultry, and corn. It is also a major producer of steel, aircraft, automobiles, and auto parts, yet surprisingly, a relatively small trader by world standards. The United States is Brazil's largest single-country trading partner.

Brazil is critical of U.S. trade policies such as the Byrd Amendment (repealed, but program in effect until October 1, 2007), which directs duties from trade remedy cases to affected industries, the administration of trade remedy rules, and what it considers to be discriminatory treatment in the U.S. expansion of free trade agreements in Latin America. It also objects to product-specific barriers such as tariff rate quotas on sugar, orange juice, ethanol, and tobacco; subsidies for cotton, ethanol, and soybeans; and prolonged antidumping orders on steel and orange juice. U.S. concerns focus on Brazil's comparatively high tariff structure, especially on industrial goods, Mercosul's common external tariff program, and Brazil's refusal to address issues of critical importance to the United States such as services trade, intellectual property rights, government procurement, and investment.

Despite these differences, both countries recognize the potential for important gains to be had from mutually acceptable trade liberalization at all levels. As a developing country with an opportunity for considerable growth in both exports and imports, however, Brazil may have the most to gain from addressing both foreign barriers to its trade, and unilaterally opening its economy further.

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Brazilian Trade Policy and the United States

As the largest and one of the most influential countries in Latin America (see **Figure 1**), Brazil has emerged in recent years as a leading voice for developing countries, particularly in setting regional and multilateral trade agendas. Brazil led in the creation of the Southern Common Market (Mercado Común do Sul — Mercosul), is a co-chair with the United States of the Free Trade Area of the Americas (FTAA) negotiations, was a founding member of the Group of 20 (G-20) coalition that represents developing country interests in the Doha Development Round of the World Trade Organization (WTO) negotiations, and meets bilaterally in working sessions with the United States on trade (and other) issues, in part because of its influence in all these groups.¹

Brazil is the 15th largest U.S. export market, but a distant second to Mexico as the United States' top trading partner in Latin America. For economies of their size, Brazil and the United States actually trade rather little with each other. Trade and investment between the two is growing, however, and the potential for deeper economic relations was a prominent theme in the two meetings that Presidents George W. Bush and Luiz Inácio Lula da Silva have held. During President Bush's visit to Brasilia in November 2005, the two presidents issued a joint communique reinforcing the importance of: 1) building on the many bilateral working groups already established; 2) increasing cooperation on trade matters at the WTO; and 3) taking advantage of the potential to double bilateral trade by 2010.²

The United States and Brazil have purposely cultivated a constructive relationship in pursuit of their respective efforts to promote trade liberalization. This is important because as a developing country, Brazil's trade priorities can vary from those of the United States, and the two are often at odds over specific trade practices. This has ranged from disagreements that have halted progress on the FTAA, to ongoing trade disputes before the WTO. For the United States, this means that maintaining a strong working relationship with Brazil is important for making progress with its own trade agenda. To assist Congress in understanding Brazil's stance on regional and global trade matters, this report analyzes Brazil's foreign trade policy and how it affects its trade relations with the world and the United States. It will be updated periodically.

¹ Mercosul is the Portuguese variation of the more widely seen Spanish acronym Mercosur. It includes Brazil, Argentina, Uruguay, and Paraguay, with six other South American countries affiliated as associate members. The FTAA is a proposed free trade area that would encompass 34 countries of the Western Hemisphere (all except Cuba).

² Joint Statement on the Occasion of the Visit by President George W. Bush to Brazil. November 5-6, 2005.

Figure 1. Map of Brazil



Source: Map Resources. Adapted by CRS. (K.Yancey 11/28/05)

Brazilian Foreign Trade Strategy

David Ricardo postulated the rationale for free trade some 200 years ago when he argued that countries could improve their national welfare if they exploited their comparative advantage by exporting those goods at which they were relatively more efficient at producing and importing the rest. Later arguments for trade pointed to the benefits arising from intra-industry trade (and investment) in which specialized production along with scale economies could lead to even more efficient exchange and innovation-driven productivity increases. These foundational ideas, which recognize the value of both imports and exports, remain valid today for explaining why countries generally wish to pursue freer trade and why trade liberalization has been at the center of the economic reform debate in much of Latin America.

In practice, however, few countries have opted unilaterally to throw open their borders to unfettered free trade, and the call to maintain trade barriers is common even if it is understood that they come with a cost to society as a whole. There are many reasons for this. Perhaps most transparent is resistance by firms and workers who stand to bear most of the adjustment costs of freer trade, even if national welfare is ultimately enhanced through lower priced goods and services, a greater selection of choices from imports, and overall efficiency gains that can lead to higher national income. Less obvious is that countries adopt diverse trade policies based on historically, socially, and politically determined “trade preferences” that cannot be explained solely by a calculus of economic costs and benefits.

The “trade preference” framework helps explain Brazil’s trade strategy. It pegs Brazil as a “regional leader” based on its leadership in pressing for South American economic integration, its conditional support of multilateral negotiations, and its reticence to consummate separate trade deals with developed countries.³ Brazil’s trade preferences in order of priority are: 1) expand and strengthen Mercosul, where Brazil is the undisputed industrial hub and political leader; 2) advocate developing country interests in the Doha Round, especially on agricultural issues, and; 3) resist what it views as a welfare reducing, U.S.-designed FTAA, and to a lesser extent, also a preferential trade arrangement with the European Union unless it serves as a counter influence to the FTAA.⁴

Brazil and the United States approach trade liberalization from different perspectives. U.S. trade strategy has been characterized as “competitive

³ The “trade preference” framework is developed in Aggarwal, Vinod K. and Ralph Espach. *Diverging Trade Strategies in Latin America: A Framework for Analysis*. In: Aggarwal, Vinod K., Ralph Espach, and Joseph S. Tulchin, eds. *The Strategic Dynamics of Latin American Trade*. Woodrow Wilson Center Press. Washington, D.C. 2004. p. 4-5. By comparison, Chile with its unilateral reduction in trade barriers and multiple trade agreements would be a “multilateral trader,” and Argentina would be a “regional partner” based on its supportive role for regional integration. See pp. 11-12.

⁴ Da Motta Veiga, Pedro. *Regional and Transregional Dimensions of Brazilian Trade Policy*. In: Aggarwal, Vinod K., Ralph Espach, and Joseph S. Tulchin, eds. *The Strategic Dynamics of Latin American Trade*. Woodrow Wilson Center Press. Washington, D.C. 2004. pp. 180-183 and multiple interviews by the author with Brazilian trade officials.

liberalization,”⁵ where simultaneously negotiating comprehensive multilateral, regional, and bilateral pacts allows gains to be achieved where parties can agree. It is competitive in that gains at one level of negotiation (e.g. bilateral or regional) can create new incentives or pressures to make breakthroughs at other levels (e.g. regional or multilateral). It is comprehensive by its inclusion of issues that go beyond market access such as services trade, intellectual property rights, government procurement, and investment.

Brazil has a narrower and more cautious tack, restricted largely to market access and dominance in regional trade, where it feels most ready to compete. The perceived benefits of Brazil’s strategy include attaining greater bargaining power through the Mercosul coalition, slowing the multilateral trade liberalization process to allow more time for economic adjustment, and enhancing its national influence in the world by protecting domestic economic (industrial) capacity. These “trade preferences” are not randomly determined, but are deeply embedded in the country’s industrial, foreign, and macroeconomic policies, discussed below.

Trade and Industrial Policy

The “regional leader” category captures well the influence Brazil’s economic development strategy has had on its trade preferences and policy. Brazil adopted its own version of the import substitution industrialization (ISI) model employed throughout much of Latin America in the 20th century. To promote industrial development, Brazil created, and protected from foreign competition, important government sponsored enterprises that still operate today, although some are now privatized. These include the National Steel Company (CSN) founded in 1942; Petrobras, the national petroleum company, established in the 1950s; the National Economic and Social Development Bank (BNDES), created in 1952; and Embraer, a leading manufacturer of regional jets, incorporated in 1969.⁶ BNDES was at the heart of this policy, providing financing for public infrastructure and strategic industries. It continues today as a necessary major source of long-term business financing given the unique structure of Brazil’s financial system.

Brazil’s industrial policy achieved notable results for decades, but with predictable tradeoffs. The inward orientation of the ISI model shielded domestic industry from global competition, diminishing market incentives to innovate and become more efficient. Trade policy was essentially administered protectionism.⁷

⁵ Although this concept is widely associated with Robert Zoellick, first USTR in the George W. Bush administration, it has an intellectual antecedent in: Bergsten, C. Fred. *Globalizing Free Trade*. *Foreign Affairs*. May/June 1996. pp. 105-106.

⁶ Gordon, Lincoln. *Brazil’s Second Chance: En Route toward the First World*. Brookings Institution Press, Washington, D.C. 2001. pp. 35 and 44.

⁷ This policy was overseen by the Carteira de Comércio Exterior do Banco do Brasil (CACEX), created during the military dictatorship (1964-1985). Trade policy today is set by the President with the Foreign Ministry as the lead agency. The Foreign Trade Board (Câmara de Comércio Exterior — CAMEX), created in 1995, acts as an advisory agency for all government departments. Cross-sectoral business interests are voiced by the Brazilian
(continued...)

The large state bureaucracy also contributed to inefficiency and the high cost of doing business in Brazil. Although privatization efforts in the 1990s have improved the competitive landscape in Brazil, the so-called Brazil cost or “Custo Brasil” endures, which is one way of saying there are numerous microeconomic distortions introduced by excessive taxation, high interest rates, cumbersome regulations, and corruption.⁸ The large untaxed informal economy combined with Brazil’s big government, for example, mean that formal businesses pay up to 85% of the tax burden, more than twice that of the United States.⁹ These issues directly diminish Brazilian productivity and indirectly deter trade liberalization. Yet, continuing to protect this regulatory regime and Brazil’s “national production structure” remains an important aspect of the national trade strategy, a priority Brazil pursues unilaterally and through Mercosul.¹⁰

Trade and Foreign Policy

As with all countries, Brazil’s foreign policy shapes its trade preferences, but compared to the United States it plays a more prominent role. Unlike the United States where trade policy is constitutionally defined as the responsibility of Congress and carried out in a separate cabinet-level agency (the United States Trade Representative — USTR), in Brazil it is undertaken by the executive branch under the purview of the Ministry of Foreign Relations. The most important aspects of trade policy, therefore, are driven less by commercial interests and often are subordinated to a larger foreign policy imperative, primarily, enhancing Brazil’s influence in Latin America and the world. In the Western Hemisphere, this implies taking on the United States. In the words of one Brazilian expert, “Brazil’s foreign policy over the past four decades is characterized by competition with the United States, and the objective of developing the nation’s industrial capacity as a key condition for independent activities within the international system.”¹¹

Economically, there are two sides to this policy: offensively, it seeks to integrate South America; defensively, it seeks to deter encroaching U.S. economic influence in the region. Brazil’s government has taken steps recently to realize this agenda, by

⁷ (...continued)

Business Coalition (Coalizao Empresarial Brasileira — CEB), established in 1996. NGOs, trade unions, and other independent groups are represented in coalition groups, such as the Brazilian Network for the Integration of People (Rede Brasileira pela Integracao dos Povos — REBRIP). Marconini, Mario. *Trade Policy-Making Process in Brazil*. Mimeo. March 2005. pp. 2-3 and 8-9, and author’s interviews with Brazilian trade officials.

⁸ Globally, Brazil ranks at the bottom for the number of regulations and time it takes to start a new business, and is also known for its cumbersome labor force regulations. See The World Bank. *Doing Business in 2005: Removing Obstacles to Growth*. Washington, D.C. 2005. pp. 19, 28, and 89-97.

⁹ Lewis, William W. *The Power of Productivity: Wealth, Poverty, and the Threat to Global Stability*. University of Chicago Press, Chicago, 2004. pp. 140-41.

¹⁰ Pedro Da Motta Veiga, *Regional and Transregional Dimensions of Brazilian Trade Policy*, p. 183.

¹¹ *Ibid.*, p. 177.

establishing in 2004 the South America Community of Nations as a loosely interwoven example of political and economic integration and by limiting progress on the U.S. version of the FTAA. Although intentions may not be overtly adversarial, these two policies do present a challenge to the U.S. trade agenda. By extension, Brazil's leadership in the region is played out at the WTO where it is an unyielding force in pushing for reductions in agricultural barriers in the Doha Round.

The foreign policy aspect of trade policy may also be seen in the emphasis on deepening developing country trade relations. In addition to negotiating for developing country interests in multilateral and regional trade talks, Brazil has also consummated an agreement with the Andean countries, India, and South Africa, and deepened relations with Portuguese-speaking African countries, by concluding various commitments on trade. Progress in the Doha Round, FTAA, and EU negotiations has proven harder to achieve.¹²

Trade and Macroeconomic Issues

Macroeconomic challenges have and continue to constrain Brazil's trade policy options. Brazil, for example, is known for its historical accommodation to inflation, having employed for decades a comprehensive system of wage, price, and interest rate indexation as part of its macroeconomic management. Inflation ran at "manageably" high rates for years and was fought, albeit unsuccessfully, with a number of stabilization plans. By the 1970s, however, it eventually spiraled out of control following the oil price shocks. This led Brazil to the 1980s debt crisis along with much of Latin America.¹³ By the 1990s, the economy was defined by its growing deficits and debt, failed efforts at stabilization, slow growth (averaging only 2.3% from 1980 to 2004), and reluctance to embrace reforms. An important factor in Brazil's sluggish economic performance was poor productivity growth due to microeconomic policy distortions discussed above, macroeconomic problems, and to some degree, also its closed trade policy.¹⁴

Brazilian trade policy also had to adjust to encroaching globalization in the 1990s, including multilateral efforts (the conclusion of the Uruguay Round), new regional talks (the FTAA), and U.S. subregional initiatives (the North American Free Trade Agreement — NAFTA). Brazil responded with some unilateral liberalization,

¹² Mario Marconini, *Trade Policy-Making in Brazil*, p. 5

¹³ In the 1970s, Brazil was a major importer of oil, but the government delayed passing on the full price increase to the public, financing the difference with debt. By 1982, this subsidy proved unsustainable and when eliminated, the higher price doubled the annual inflation rate to nearly 100%. Because of indexation, the oil price increase was passed on to wages, which then showed up as more price inflation. Suddenly, it seemed, Brazil was swamped by debt and spiraling hyperinflation, and so began the lost decade of the 1980s. For a good discussion of the economic points, see Dornbusch, Rudiger. Brazil's Incomplete Stabilization and Reform. *Brookings Papers on Economic Activity*. William C. Brainard and George L. Perry, editors. Washington, D.C. 1997. pp. 371-374.

¹⁴ Blyde, Juan S and Eduardo Fernnandez-Arias. *Economic Growth in the Southern Cone*. Economic and Social Study Series. RE1-04-004. Inter-American Development Bank. Washington, D.C. April 2004. pp. 1-3, 10, and Lewis, *The Power of Productivity*, p. 138.

the formation of Mercosul in 1991 with Argentina, Uruguay, and Paraguay to consolidate its trade positions in South America, and the adoption of a government-assisted export promotion policy to help address its large and growing external debt. The average tariff in Brazil fell from 51% in 1988 to 14% in 1994, but the selective preferences given under Mercosul belied the liberalization message as Brazil continued to limit trade outside the regional pact, allowing it to manage carefully the degree to which foreign competition would be accepted.¹⁵

Brazil's trade policy shifted again in 1994 to accommodate the *Real* Plan, a price stabilization policy imposed by then-Finance Minister (and later-President) Fernando Henrique Cardoso. It was named for a new currency that was pegged to the U.S. dollar to serve as an anchor to bring down hyperinflation. The plan actually worked where others had not, but in pegging the *real* to the dollar, the differences in inflation between the two countries caused a large real appreciation of the Brazilian currency, as price levels between the two countries diverged. This resulted in a sudden turn to trade deficits in 1995 (see **Figure 2**), an economic consequence that ran counter to the political priority given to running trade surpluses. To offset the exchange rate effect on the balance of payments, Brazil raised interest rates and redoubled its protectionist policies.¹⁶

The macroeconomic story was further complicated by a major financial crisis in 1998 that resulted in a currency devaluation and return to a floating exchange rate in 1999, Argentina's financial collapse in 2001, and a financial panic in 2002 exaggerated by the impending presidential election of longtime Worker's Party leader Luiz Inácio Lula da Silva. Today Brazil's macroeconomic priorities still constrain trade and other policy choices. The economy is stable, but growing at inadequate levels to bring about desired development goals. To control inflation, the Lula Administration has had to maintain very high real interest rates, while Brazil's large debt service obligation has required a large primary budget surplus, approaching 5% of GDP in 2005, and a trade surplus.¹⁷

The cost of this development strategy has been accepting the microeconomic distortions discussed above and inadequate social spending, which raises the prospect for future social and political unrest given the already very high levels of income inequality and poverty. Subordinating trade liberalization to debt reduction and other goals also diminishes Brazil's growth prospects, a key variable in reducing poverty. Therefore, as may be seen, Brazil's "trade preferences," which point to a cautious (some would say protective) and carefully managed approach to trade liberalization,

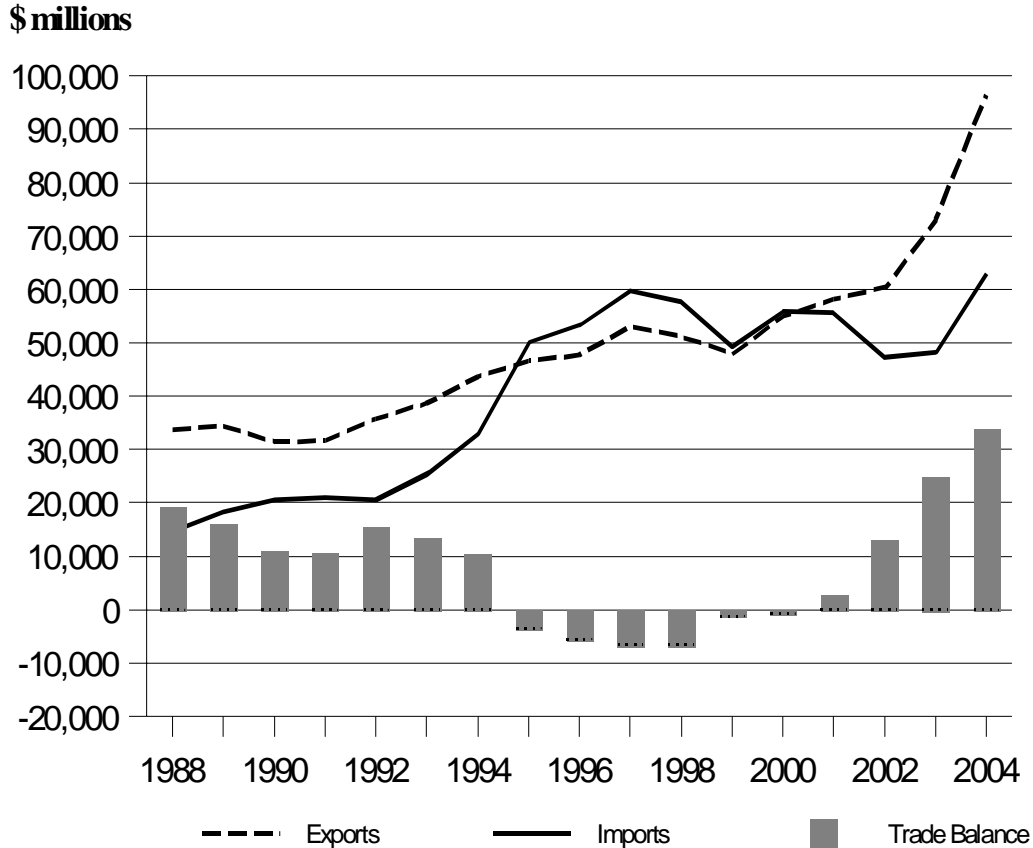
¹⁵ Costa Vaz, Alcides. Trade Strategies in the Context of Economic Regionalism: The Case of MERCOSUR. In: Aggarwal, Vinod K., Ralph Espach, and Joseph S. Tulchin, eds. *The Strategic Dynamics of Latin American Trade*. Woodrow Wilson Center Press. Washington, D.C. 2004. pp. 235 and 255-57.

¹⁶ Pedro Da Motta Veiga, *Regional and Transregional Dimensions of Brazilian Trade Policy*, p. 178.

¹⁷ The primary surplus is the fiscal surplus not including interest payments, and theoretically represents the amount available for debt service. Real interest rates (adjusted for inflation) in Brazil have hovered around 10% for years, making them among the highest in the world.

reflect a combination of industrial, foreign, and macroeconomic policy priorities that often outweigh purely trade-related economic arguments, and deters progress in Brazil's long-term development. These points bear remembering when considering specific trade negotiation stances and disputes, discussed later.

Figure 2. Brazil's Balance of Merchandise Trade, 1988-2004



Data Source: Boletim do Banco do Brasil, September 2005.

Brazilian Trade with the World

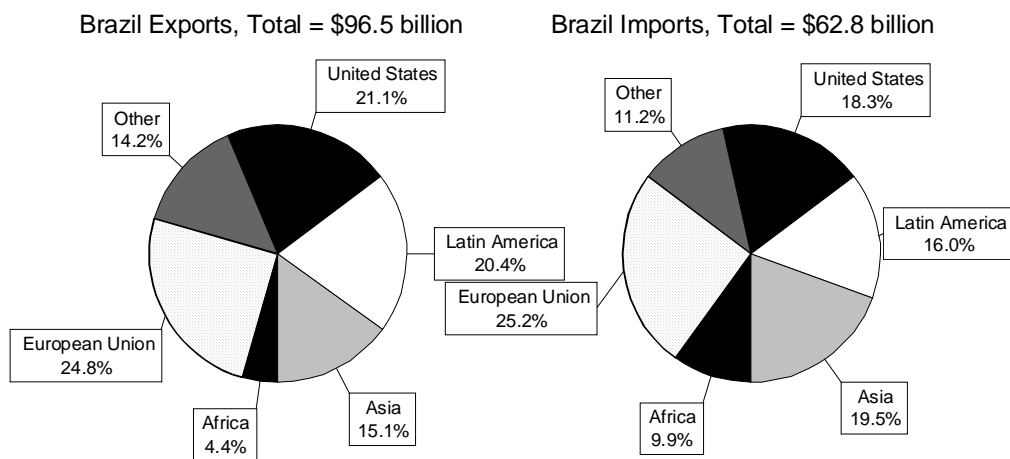
Brazil has a modern, diversified economy, with services accounting for 53% of GDP, followed by industry and manufacturing at 37%, and agriculture at 9%. Depending on how agribusiness is measured, it contributes to some 30% of GDP. Brazil is the number one producer of raw sugar, oranges, and coffee in the world, and the second largest producer of soybean, beef, poultry, and corn.¹⁸ It is also a major producer of steel, aircraft, automobiles, and auto parts. By comparative standards, however, Brazil is actually a small trader, with total trade accounting for only 26% of GDP in 2004, up from 14% a decade earlier, but still a relatively small amount compared to the rest of Latin America. Brazil represents only 0.9% of world trade,

¹⁸ Data from Brazilian Institute of Geography and Statistics and Brazilian Embassy, *Highlights of Brazilian Agriculture*, September 2004.

a number that has not grown, suggesting that Brazil's trade liberalization efforts have not resulted in any change in its trade openness relative to the rest of the world.

Brazil's global trade is diversified (see **Figure 3**), with 25% of exports going to the European Union, 21% to the United States, 20% to Latin America, and 15% to Asia. Brazil's imports mostly from the European Union (25%), Asia (20%), the United States (18%), and Latin America (16%). Brazil's top three trading partners are the United States, Argentina, and Germany. Together they account for over one-third of Brazil's world trade and each, interestingly, is the dominant trading partner of a different region or trade group (NAFTA, Mercosul, and the European Union).

Figure 3. Brazil's Direction of Trade, 2004



Some 30% of Brazil's merchandise exports are primary products, 14% semi-manufactured goods, and 56% manufactured goods (see **Appendix 1**). Importantly, natural resource-based goods dominate in all categories. For example, together all steel and aluminum based products, fabricated to varying levels of completion, represent 10% of total exports. Agricultural products, including raw sugar and other products, as well as, manufactured goods like orange juice and refined sugar, and semi-manufactured sugar and soybean products, account for at least 30-40% of exports. Soybean and soybean products alone amount to 10% of exports, more than automobile and related parts (8%) and aircraft (3%).¹⁹ These numbers provide some insight into why Brazil places such a strong emphasis on further opening developed country markets to its agricultural products.

¹⁹ Data from *Boletim do Banco Central do Brasil*. September 2005 and Jales, Mario. *Brazilian Agribusiness in International Trade and WTO Negotiations*. Presentation made June 12, 2006. Available at [<http://www.lconebrasil.org.br>].

Brazilian imports fall into five categories: capital goods (17.6%); consumer goods (10.8%); durable consumer goods (4.9%), fuels (16.4%); and intermediate goods (50.3%). Brazil imports capital and intermediate goods in support of its own industrial and agricultural growth, development, and export. These goods range from aircraft engines to chemicals and pharmaceuticals that are used in processing other goods. Raw materials for farming, foodstuffs, and nondurable consumer goods round out the major imports.

Brazil's trade priorities cannot be derived entirely from a calculation of the trade-weighted importance of trade partners. The United States is Brazil's largest single-country trading partner, yet Brazil has resisted increasing trade liberalization with the large U.S. market via the FTAA because the U.S. model of liberalization is viewed as insufficiently balanced to meet Brazilian needs. To appreciate Brazil's approach to the United States and the world with respect to trade negotiations, it is critical to see how its "trade preferences," discussed above, take form in actual negotiations. Mercosul is most important to the economic and political life of Brazil and has taken on perhaps even greater priority under the Lula administration. It is discussed first followed by Brazil's approach to the FTAA and WTO, which will allow for a better understanding of U.S.-Brazil trade relations, as a whole.

Southern Common Market (Mercosul)

Mercosul was created in 1991, the outgrowth of Brazil-Argentine bilateral efforts in the late 1980s to address longstanding political and security concerns. By including Uruguay and Paraguay, and defining the partnership along economic lines, Mercosul was expected to help the region improve its chances for mutual economic growth and development, and thereby stabilize regional political relations as well. Mercosul has succeeded on the political side and also developed as a credible collective voice in the WTO and the FTAA. Its success at economic integration is more questionable.

Mercosul began as a free trade area, but was designed to evolve into a customs union, defined by a common external tariff (CET), and eventually, a common market with the free movement of goods, investment, and labor. To date, Mercosul remains an incomplete customs union with many exceptions to the CET. Early successes were measured by the doubling of intra-Mercosul trade by 1995, as tariffs came down according to schedule, and cooperation remained largely positive. This trend reversed course in the late 1990s because of financial crises in Argentina and Brazil, and the absence of macroeconomic coordination and other policy problems. Brazilian trade within Mercosul expanded by only 13% from 1999 to 2004, with Brazil's trade balance shifting from a nearly balanced position to an uncomfortably large surplus of \$2.5 billion by 2004, as imports from all three Mercosul partners stagnated or declined. Argentina responded with quotas and higher tariffs on certain Brazilian exports and calling for more equitable bilateral trade flows.

In reality, the trade rationale for Mercosul was always limited and fraught with challenges. After 15 years, Mercosul accounts for only 9% of Brazil's exports. The United States and Europe remain the dominant markets for Brazilian manufactures and agricultural goods, respectively, as well as, the major suppliers of capital goods. Argentina and Brazil have both resorted to raising trade barriers against each other

in response to sectoral and macroeconomic problems, and Brazil stands alone as the industrial center, so Mercosul offers little competition in technological and innovative-based industries that can bring deeper gains from trade.

The increased intra-dependence fostered by a successful Mercosul also carries certain risks, as seen in the compression of trade and economic growth in Paraguay and Uruguay following financial crises and currency devaluations in Brazil (1999 and 2001) and Argentina (2002). These setbacks merely confirmed what has been widely understood, that Mercosul was really launched as a “political project carried out in the economic and commercial realms.”²⁰ Deeper economic integration, under these circumstances, has proved elusive.

In response, Mercosul turned to broadening its membership rather than deepening the arrangement. Chile and Bolivia acceded to Mercosul in 1996 as associate members (not subject to the CET and other provisions), and after years of negotiation, the Andean Community of Nations (Ecuador, Bolivia, Venezuela, Peru, Colombia) was added in October 2004. Brazil took a further step in organizing the South American Community of Nations in December 2004, which is a very loose arrangement of the twelve major South American countries.²¹ In December 2005, Venezuela agreed to become a full member of Mercosul, and has been promised full membership status, except for voting, despite its inability to adopt the CET and other policies. A similar proposal has been suggested for Bolivia following the presidential election of leftist Evo Morales in December 2005. These decisions suggest that Mercosul continues to operate based primarily on political incentives.

Mercosul has been negotiating with the European Union for an FTA for many years. These talks, once considered promising, have bogged down on market access and other issues that have similarly hindered progress on the FTAA. Brazil wants better access for agricultural goods, while the EU wants Brazil to lower tariffs on industrial goods. Brazil is unwilling to make such a commitment until the EU also addresses its agricultural subsidy program. Currently, the talks are stalled, with little expectation of significant movement in the near future, a prospect, as with the FTAA, that may hinge on developments in the Doha negotiations.

Despite the undisputed expansion in Mercosul affiliation, growth in trade has stagnated and after 15 years, by most accounts, the pact still lacks institutional strength and coordination, providing little evidence of enhanced trade-related productivity gains.²² Still, support for the pact is strong despite its troubles. The

²⁰ Costa Vaz, *Trade Strategies in the Context of Economic Regionalism*, pp. 234-235 and Weintraub, Sidney. *Development and Democracy in the Southern Cone: Imperatives for U.S. Policy in South America*. Center for Strategic and International Studies. Washington, D.C. February 2000. pp. 12-13.

²¹ Details on the various Latin American integration efforts may be found in: CRS Report RL33162, *Trade Integration in the Americas*, by M. Angeles Villarreal.

²² The limits of Brazil's trade-related productivity gains from Mercosul are analyzed in: Lopez-Cordova, Ernesto and Mauricio Mesquita Moreira. *Regional Integration and Productivity: The Experiences of Brazil and Mexico*. In: Estevadeordal, Antoni, Dani (continued...)

smaller economies benefit from preferential access to the large Brazilian market, and Brazil sees a unified Mercosul as being the definitive counterbalance to the United States in FTAA negotiations, where the FTAA is viewed as a complement to, not a substitute for, Mercosul. The technical distinction between a free trade agreement and a customs union becomes important here. A customs union with a CET implies that its members will negotiate trade agreements collectively with the outside world, or the union becomes largely meaningless.²³

For these many reasons, Mercosul remains at the heart of Brazil's trade strategy. Brazil relies on the customs union to strengthen its regional economic leadership, and by extension, its trade negotiating position outside of Mercosul. Conversely, Brazil's strength would be undermined if any members of Mercosul opted for FTA status or chose to go their own way with extra-regional negotiations, a position Uruguay flirted with in January 2006, although apparently with no real conviction. Mercosul also serves Brazil's trade strategy precisely because Brazil can set the levels of deepening to ensure a balance between maintaining its industrial policy and co-opting regional voices in approaching the EU, WTO, or FTAA. Finally, Brazil uses Mercosul as a way to ease its transition to trade liberalization in the global economy because it has a ready-made regional comparative advantage in manufacturing.

Free Trade Area of the Americas (FTAA)

The FTAA is a proposed free trade area that would include 34 nations (all except Cuba) of the Western Hemisphere. It has been under consideration for a decade, but talks effectively stalled in late 2003. Problems arose over differences between Brazil and the United States, which as the co-chairs of the Trade Negotiations Committee (TNC), hold the key to consummating the agreement. At the heart of the disagreement are their diametrically opposing positions that reflect not only differences in sectoral and industry issues, but in broader trade preferences as well. The United States remains committed to an agreement that includes negotiating investment, services, intellectual property rights, and government procurement, among other issues. Brazil has not deviated from its more limited support of dealing mostly with market access, and its refusal to engage on these other issues unless the United States concedes to address agricultural subsidies and trade remedy issues.²⁴

This impasse resulted in a compromise unveiled at the 2003 FTAA Ministerial meeting in Miami calling for a two-tier agreement under which countries could assume different levels of commitment. The proposed framework, viewed by the United States as an accommodation to Brazil, would include a common set of rights and obligations for all countries along with optional obligations that could be entered

²² (...continued)

Rodrik, Alan M. Taylor, and Andrés Velasco, eds. *Integrating the Americas: FTAA and Beyond*. Harvard University Press, Cambridge, 2004. pp. 573-609.

²³ Weintraub, *Development and Democracy in the Southern Cone*, pp. 6-7.

²⁴ See CRS Report RS20864, *A Free Trade Area of the Americas: Major Policy Issues and Status of Negotiations*, by J. F. Hornbeck. pp. 5-6.

into on a plurilateral basis. Defining these various commitments so far has proven unworkable, and the breadth of an emerging resistance to the FTAA became clearer at the fourth Summit of the Americas held on November 4-5, 2005, in Mar del Plata, Argentina. Amid dramatic and sometimes violent public demonstrations against President George W. Bush and the FTAA, it was evident that Latin America was divided over how to proceed. A total of 29 countries supported renewing negotiations, and the United States pushed to set a specific date in 2006.

Brazil, Argentina, Uruguay, and Paraguay (the Mercosul countries) rejected this idea, arguing that the conditions for achieving a balanced and equitable agreement did not yet exist. Taking a more extreme position, Venezuela lobbied to end any further effort on the FTAA and for unified resistance against U.S. policies and presence in Latin America. The Summit declaration called for a time to explore problems in the FTAA process, while awaiting the outcome of the upcoming World Trade Organization (WTO) ministerial, indicating that at this juncture, there is no unified vision on how to proceed with the proposed FTAA. Brazil continues to offer to negotiate market access talks between the Mercosul countries and the United States (the so-called "4+1" option), an overture the USTR has repeatedly declined.

Brazil sees little advantage to an FTAA at this point in time, particularly one that does not address its interests, and so appears content with the status quo for the indefinite future. The United States, by contrast, has been frustrated by an inability to advance a NAFTA-like region-wide agreement. Therefore, it appears that Brazil will continue to reinforce support for Mercosul, while biding its time on the FTAA and attempting to make headway with agricultural issues in the WTO.

Mercosul negotiates the FTAA as a bloc, which may gather strength if Venezuela joins as a full member.²⁵ Interestingly, most analyses of the economic effects of joining the FTAA point to differences in costs and benefits between Brazil and the other three smaller members. The gains for Mercosul as a whole would come from its comparative advantage in agriculture vis-a-vis the United States, provided barriers to trade in this sector are meaningfully lowered. For Brazil, opening up the U.S. market to agricultural products is critical, but the United States is also its major market for many value-added manufactured exports (frozen orange juice concentrate, steel, aircraft, petroleum). There is, it seems, the potential for considerable commercial gains for Brazil should a far-reaching FTAA be completed.²⁶

²⁵ It has been noted that the addition of Venezuela as a full member of Mercosul consolidates in one bloc all the countries resisting the FTAA, setting up the potential for a major political standoff with the United States on this issue. *Latin American Brazil and Southern Cone Report*, December 2005, p. 7.

²⁶ Weintraub, *Development and Democracy in the Southern Cone*, p. 12, Laens Silvia and Inés Terra. Integration in the Americas: Welfare Effects and options for the MERCOSUR. In Lorenzo, Fernando and Marcel Vaillant, eds. *MERCOSUR and the Creation of the Free Trade Area of the Americas*. Woodrow Wilson International Center for Scholars, Washington, D.C. 2005. p. 107, and Masi, Fernando and Carol Wise. Negotiating the FTAA between the Main Players: USA and MERCOSUR. In: Lorenzo and Vaillant, *MERCOSUR and the Creation of the Free Trade Area of the Americas*, p. 323.

The cost and benefit calculus, however, is more complicated. For the smaller Mercosul countries, an FTAA means giving up preferential access to the large Brazilian market, which could mean a net loss in welfare for some sectors. The FTAA would also mean greater access to the U.S. and other Latin American markets, and reduced costs for capital goods and other imports that no longer face a high Mercosul CET (e.g. 35% in the case of automobiles). The smaller economies might also consider the effects of any future economic setbacks from potential macroeconomic problems in Brazil or Argentina. Brazil also is reticent to push for an FTAA precisely because with Mercosul (and more so with a functioning South America Community of Nations), it is the hub and industrial center of a major preferential trade arrangement, which would certainly change in importance if the FTAA comes to be.

With an FTAA, Brazilian manufacturing industries that compete directly with more efficient U.S. firms (e.g. machinery and chemicals) could lose in the short run. Combined with possible trade restructuring that other Mercosul countries might face, Brazil's comparative advantage might shift, to some degree, from industrial products in a regional economic union to more agricultural goods in a hemispheric one. Given the economic and political strength of the United States, the FTAA might alter the balance of power in the region, to the possible detriment of Brazil's regional leadership. The potential for these relative changes, compounded by Brazil's concerns over its ability to conform to provisions covering enforceable intellectual property rights, services trade, and investor protection, point to why Brazil remains reluctant to advance an FTAA, particularly if U.S. agricultural protection remains relatively untouched. Stated more succinctly, although an FTAA could provide commercial (and certainly consumer) gains to Brazil, it may come at a cost to industrial and foreign policy priorities.²⁷

For the United States, even a two-tier FTAA may make sense, particularly if the alternative is an FTAA without Brazil. With a two-tier FTAA, most of the hemisphere would be integrated, including Brazil, at least nominally. It may be viewed as a way to co-opt Brazilian reticence, or at least diminish the stalemate approach that can also extend to other Mercosul countries. Given Brazil's deeply held concerns that reflect its "trade preferences," however, the status quo (impasse) seems to be Brazil's preferred position between moving ahead with the FTAA negotiations or killing them outright.²⁸

World Trade Organization (WTO)

Brazil has also been a vocal leader of the G-20 that represents developing country interests in the WTO. Even prior to forming the G-20 group, Brazil stood

²⁷ Lorenzo and Vaillant, eds., *Mercosur and the Creation of the Free Trade Area of the Americas*, various chapters, pp. 4, 38, 152, and 324.

²⁸ The future of the FTAA remains unclear from the Brazilian perspective. At the conclusion of the WTO Hong Kong Ministerial in December 2005, Ambassador Adhemar Bahadrian, Brazil's FTAA co-chair representative, suggested that the FTAA may be put off for at least another year. He was, however, replaced soon thereafter as the co-chair, and Brazil has signaled that it is still interested in negotiating with the United States in 2006.

up for including matters critical to developing countries in the WTO including the most pressing issue, barriers to agricultural trade, as well as, the treatment of rules covering antidumping and pharmaceutical data protection, among others.²⁹ In particular, Brazil has insisted on addressing the reduction of barriers to agricultural trade, particularly export and production subsidies. The United States is working in the WTO negotiations with Brazil to find a way to reduce agricultural subsidies, resists addressing antidumping rules, but is generally sympathetic to finding a solution to developing country concerns over providing drugs for HIV/AIDS and other emergencies.³⁰

The implication for Brazil-U.S. trade relations is that the WTO is an arena where the two countries can find areas of both commonality and disagreement. For many issues, the United States has indicated that the multilateral forum is the preferred or only venue for issue resolution (domestic agricultural subsidies) and so progress in addressing Brazilian concerns in the FTAA are contingent, at a minimum, upon success at the WTO. Brazil has taken similar stands with respect to services trade, intellectual property rights, and other issues. Hence, it is important to integrate the various factors that drive Brazilian trade priorities at the different levels of negotiation to be able to interpret Brazil's underlying intent and perhaps offer some understanding of why U.S. negotiators have been frustrated in their attempts to move forward on some critical U.S. trade policy initiatives, especially the FTAA.

At the latest WTO ministerial in Hong Kong, Brazil played a leading role in continuing to represent developing country interests in the Doha Round. Its voice was prominent in becoming a member of the latest group of would-be brokers of a Doha Round agreement known as the Group of Six (EU, U.S., Japan, Australia, Brazil, and India). The WTO remains an important forum for Brazil, which could be a major winner if barriers to agricultural trade are significantly reduced. In the post-Hong Kong period, Brazil has expressed a readiness to offer reductions in barriers to trade in industrial goods and services, if the United States can convince the European Union to move forward on agricultural barriers. The current level of cooperation between Brazil and the United States bodes well for making headway in multilateral talks that could "trickle down" to regional and bilateral accommodations. This outcome, however, is far from assured.

U.S.-Brazil Trade Relations

Brazil and the United States are two independent political and economic leaders in the Western Hemisphere, and is reflected in their trade relationship. First, unlike much of Latin America, Brazil does not have a preferential trade arrangement with the United States such as NAFTA, the CBI, or the Andean Trade Preference Act, although it is protective of its U.S. preferences provided under the Generalized

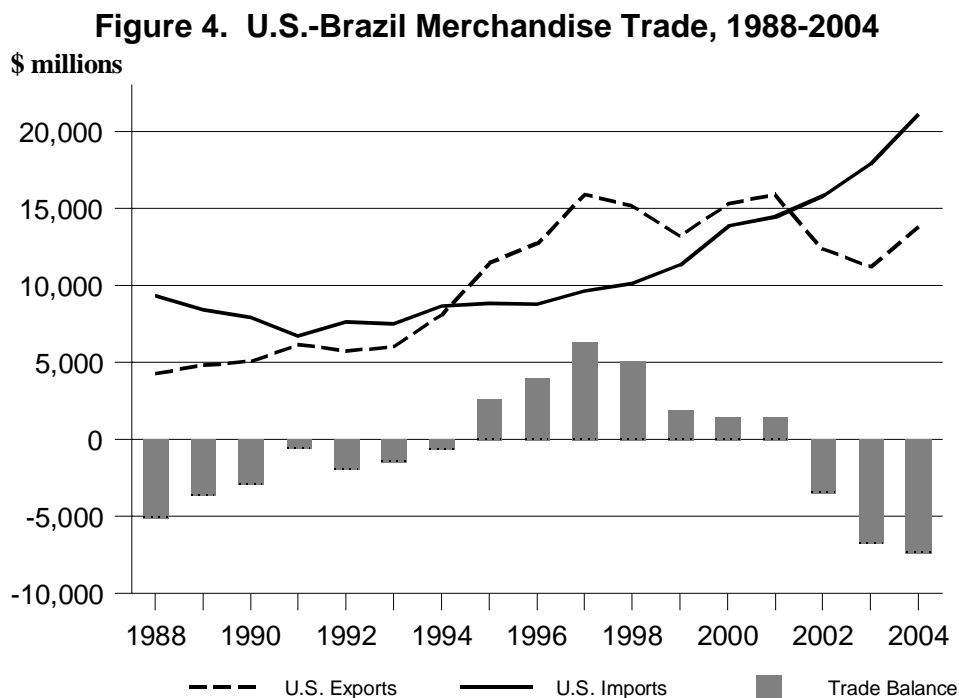
²⁹ Fishlow, Albert. Brazil: FTA or FTAA or WTO? In: Schott, Jeffrey J., ed. *Free Trade Agreements: US Strategies and Priorities*. Institute for International Economics. Washington, D.C. 2004. pp. 285-287.

³⁰ For a comprehensive discussion of WTO issues, see CRS Report RL33176, *The World Trade Organization: The Hong Kong Ministerial*, coordinated by Ian F. Fergusson.

System of Preferences (GSP). Second, although there is consistent effort to maintain constructive engagement between the two countries at all levels of negotiation, much attention turns to areas of disagreement. Indeed, progress on the FTAA has crept to a halt, bilateral disputes have left some interests dissatisfied, including those represented in the U.S. Congress, and key issues in the multilateral realm remain largely unresolved. A look at U.S.-Brazil trade and the issues that confront the two countries help explain this situation.

U.S.-Brazil Trade Trends

Brazil is the 15th largest U.S. export market, but a distant second to Mexico as the United States' largest trading partner in Latin America. For economies of their size, Brazil and the United States actually trade rather little with each other. Total merchandise trade (trade turnover) in 2004 between the United States and Brazil was \$35 billion, or 8.2% of U.S. trade with Latin America. The United States purchased 21% of Brazil's exports and supplied 18% of its imports. The ebb and flow of U.S. bilateral trade with Brazil reflects a number of factors including their respective macroeconomic growth trends, Brazil's 1999 and 2001 devaluations (note rise in U.S. imports and fall in U.S. exports in **Figure 4** — data presented in **Appendix 2**), and after 2002, Brazil's enhanced export promotion policy.



Data Source: Boletim do Banco do Brasil, September 2005.

Brazil and the United States are far from achieving their full bilateral trade potential. It is clear that over nearly two decades, beginning before either NAFTA or Mercosul came into being, that the growth in U.S.-Brazil trade has lagged compared to U.S. trade with Latin America and especially Mexico, a close trader with the United States. As seen in **Table 1**, in 1987 Brazil accounted for 1.8% of total U.S. trade, compared to 5.3% for Mexico and 12.4% for Latin America as a whole. U.S.-Brazilian trade grew by 195% from 1987 to 2004, a meager amount

compared to the 422% growth in U.S.-Latin American trade and the 665% growth in U.S.-Mexican trade. By 2004, Brazil had lost ground, making up only 1.5% of total U.S. trade compared to Mexico's 11.7% and Latin America's 18.7%.

Table 1. U.S. Trade with Brazil, Mexico, and Latin America

	% of Total U.S. Trade 1987	% of Total U.S. Trade 2004	Total U.S. Trade 2004 (\$ millions)	% Growth in Trade 1987-2004
Brazil	1.8	1.5	35,057	195
Mexico	5.3	11.7	266,737	665
Latin America	12.4	18.7	426,849	422

Source: CRS computations from U.S. Department of Commerce data.

Nonetheless, the United States is still Brazil's largest single-country trading partner, rivaling total trade with the European Union (EU) and exceeding Brazil's trade with Latin America. A simple analysis of Brazil's trade with the world suggests that the United States could play a more important role. This point is supported by more sophisticated estimates as well. One study using a gravity model simulation suggested that Brazil's trade with the United States in 1999 was only 44% of what the model estimated it should have been.³¹

The United States exports mostly capital goods to Brazil; the top three categories composing over half of U.S. exports are:

- *machinery* (gas turbines used in the manufacture of Brazilian aircraft, computers, office machinery and engine parts);
- *electrical machinery* (integrated circuits, radio, television, and telephone parts); and,
- *organic materials* (such as industrial chemicals).

The United States is also the largest market for Brazilian manufactured goods, which are included in the top three U.S. import categories and compose nearly one-third of U.S. imports from Brazil. These include:

- aircraft (regional jet airplanes);
- electrical machinery (cell phones, radio, and other transmission apparatus); and,
- machinery (automobile engine parts).

Other important U.S. import categories include mineral fuel, iron and steel, automobiles, and footwear (see **Appendix 3** for bilateral services trade data, not discussed in this report). Treatment of Brazilian agricultural products, conspicuously absent from top categories of U.S. imports, are among Brazil's major bilateral issues.

³¹ This point is developed in Schott, Jeffrey. J. *U.S.-Brazil Trade Relations in a New Era*. Institute for International Economics. November 2003. pp. 4-5. [<http://www.iie.com>]

U.S.-Brazil Foreign Investment

Trade liberalization is also important because it tends to encourage increased foreign direct investment (FDI). Permanent and predictable trade rules induce FDI because the flow of trade will be less likely to be interrupted by government actions. If a trade agreement also includes an investment chapter, which typically assures foreign investors that they will receive national treatment and have recourse to an impartial dispute settlement process, there is further inducement for FDI. This an important issue because the United States does not have a Bilateral Investment Treaty (BIT) with Brazil, another way to secure U.S. investor rights with developing countries.

The stock of U.S. FDI in Brazil was \$33.3 billion in 2004 (see **Appendix 4**). This figure actually declined from a peak of \$37.8 billion in 1998. U.S. investment in Brazil, the largest economy in Latin America next to Mexico, is relatively small, representing only 1.6% of U.S. FDI in the world and only 10.2% of U.S. FDI in Latin America (Mexico has twice this amount). In addition, Brazil invests little in the United States, with the stock of FDI amounting to \$1.3 billion in 2004. Although this is double the previous year's level, it accounts for less than one-tenth of one percent of FDI in the United States. Brazilian investment is growing, however, concentrated in industries of strategic interest to its economy that face formidable U.S. barriers to entry, such as citrus and steel.

U.S.-Brazil Bilateral Trade Issues and Disputes

Brazil and the United States have a number of specific trade issues that are taken up at all levels of trade negotiations. As with all countries, the United States and Brazil practice some form of protection, although they are very different. The United States is most concerned over Brazil's high average tariffs, particularly on industrial goods, and multiple non-market access issues including intellectual property rights (IPR) enforcement, services trade, government procurement, and investment rules. The United States Trade Representative (USTR) considers the common external tariff (CET) a major barrier to U.S. agricultural exports, distilled spirits, and computer equipment.³²

Brazil has raised its major concerns over broad U.S. policies such as the Byrd Amendment, which directs duties from trade remedy (antidumping) cases to affected industries, the calculation of antidumping margins, and what it considers to be discriminatory treatment inherent in U.S. expansion of preferential trade agreements in Latin America (NAFTA, Chile, CAFTA-DR). The Byrd Amendment was found to be in violation of WTO rules. Although repealed by Congress on February 1, 2006, the program remains in effect until October 1, 2007. The other two complaints face no challenge in the WTO. Brazil also objects to product-specific barriers that include restrictive tariff rate quotas (TRQs — sugar, orange juice, ethanol, and tobacco), subsidies (cotton, ethanol, and soybeans), and trade remedy cases (steel and orange juice). The U.S. 2002 Farm Bill that effectively increased agricultural

³² United States Trade Representative. *2005 National Trade Estimate Report on Foreign Trade Barriers*. Washington, D.C. March 2005, p. 30.

subsidies further aggravated the situation. As of January 1, 2006, there were 17 U.S. antidumping and countervailing duty orders in place against Brazil.

Tariffs Structures. One significant difference between Brazil and the United States is their tariff structure. As shown in **Table 2**, Brazil has comparatively high average tariffs. Although the difference in average agricultural tariff is small, Brazil's average tariff on industrial products is three times that of the United States, the major product category of U.S. exports to Brazil. It follows that market access discussions between the two countries usually find the United States focusing on reduction of industrial tariffs, whereas Brazil emphasizes U.S. peak tariffs on agricultural imports subject to TRQs. The high out-of-quota tariffs are meant to deter imports to protect U.S. producers, which are, for example, 350% for tobacco and 78% for sugar, and reflected in the comparatively large standard deviation in U.S. agricultural tariffs. Brazil notes that the U.S. average agricultural tariff can mask the high cost Brazil faces from out-of-quota peak U.S. tariffs.³³

Table 2. U.S. and Brazil Average Tariff Rates

Country	All Products		Agricultural Products		Industrial Products	
	Avg. Tariff*	Standard Deviation#	Avg. Tariff*	Standard Deviation#	Avg. Tariff*	Standard Deviation
United States	4.3%	11.3	8.5%	30.2	3.7%	5.1
Brazil	10.9%	6.8	10.2%	6.0	11.0%	6.8

Data source: Inter-American Development Bank via personal correspondence.

* Simple average tariff for calendar year 2004.

Standard deviation as measure of how much tariffs can vary from average.

Brazilian Complaints Against the United States. Brazil's major product-specific complaints are summarized briefly below.

Sugar. As part of U.S. support for the domestic sugar growing and processing industry, quotas are set under U.S. commitments made under WTO rules to restrict the amount of sugar imports that may enter the country. The purpose is to maintain the domestic price of sugar above a set minimal level. The United States Department of Agriculture (USDA) allocates quotas among eligible countries, with Brazil receiving approximately 13% of the world total. In-quota imports are subject to a very low duty. Amounts entering above the quota are subject to a tariff computed by the USITC to be 78% ad valorem in 2003.³⁴ Brazil has expressed concern over the small increases in quotas given to the Central American countries under the CAFTA-DR, suggesting it bodes poorly for future negotiations with the United States, given that Brazil is the world's largest producer of raw and refined sugar.

³³ Brazil's positions in this section are summarized from: Embassy of Brazil. *U.S. Barriers to Brazilian Goods, Services, and Investment*. October 2002 and the summary update of the same publication printed in March 2005.

³⁴ For details of the sugar program, see CRS Issue Brief IB95117, *Sugar Policy Issues*, by Remy Jurenas. Brazil calculates a much higher ad valorem equivalent of 221% for 2004.

Cotton. Cotton is a protected crop in the United States, benefitting from direct payments, counter-cyclical payments, subsidized loans and other federal programs. Subsidies averaged \$1.7 billion per year for fiscal years 1991 to 2004.³⁵ Brazil successfully challenged portions of the U.S. cotton program under WTO dispute settlement rules, requiring the United States to change or withdraw these prohibited support programs. Although the United States missed the deadlines to correct these programs, Brazil, unlike some other countries, did not take retaliatory measures. Congress repealed two of the offending programs as part of the FY2006 budget reconciliation conference bill on February 1, 2006, but Brazil remains critical of remaining cotton support programs.³⁶

Steel. The steel industry files more antidumping and countervailing duty cases than any other U.S. industry, the subject of repeated complaints by Brazil.³⁷ As of January 1, 2006, there were 16 such orders in place against Brazil, some dating back to 1986. The steel issue was further exacerbated in 2002 when the United States imposed special safeguard duties of up to 30% on various steel imports, until successfully challenged in the WTO and withdrawn. Brazil estimates that the total cost of these measures exceeds \$2 billion in lost sales, and with the United States as one of its most important export markets, is eager to see restrictions reduced, if not eliminated.

Ethanol (corn). For years, both Brazil and the United States subsidized heavily the development of ethanol production from sugar and corn, respectively. Currently, Brazil's subsidy program has ended and it maintains a highly efficient ethanol production process. Brazil's exports of ethanol face two barriers to the U.S. market. First, U.S. corn production is subsidized by various U.S. programs, and some 13% of total corn production is used for ethanol. Second, there is a U.S. import duty on ethanol plus an additional 54 cents per gallon designed to offset a tax reduction all ethanol receives to offset the federal gasoline excise tax levied at the pump on all fuels.³⁸ Brazil continues to press for changes in both programs.

Orange Juice. Brazil argues that the U.S. tariff on orange juice concentrate is equivalent to 65% on an ad valorem basis and 18.4% on non-concentrated juice. In addition, the most recent U.S. antidumping order against Brazil was placed on orange juice on January 1, 2005. In January 2006, the U.S. Department of Commerce made a preliminary finding of dumping against Brazilian frozen concentrated orange juice, which Brazil has vowed to fight in the WTO.

³⁵ See CRS Report RL32571, *Background on the U.S.-Brazil WTO Cotton Subsidy Dispute*, by Randy Schnepf. p. 1.

³⁶ International Trade Reporter. *House Approves Budget Measure Containing Byrd Amendment Repeal*. February 1, 2006.

³⁷ CRS Report RL32333, *Steel: Price and Availability Issues*, by Stephen Cooney. pp. 8 and 29.

³⁸ CRS Report RL30369, *Fuel Ethanol: Background and Public Policy Issues*, by Brent D. Yacobucci and Jasper Womach. pp. 2-3 and 17.

Tobacco. Also subject to tariff rate quotas and very high over-quota tariffs, Brazil would like to see the U.S. market open more to greater imports of the product from Brazil. Tobacco represents only 1% of total U.S. imports from Brazil on a dollar value basis.

Soybeans. Brazil, the second largest producer of soybeans in the world, must compete against U.S. subsidies on soybeans ranging from \$1.5 to \$3.2 billion annually between 2004 and 2006. Brazil is evaluating whether to challenge these subsidies in the WTO, as it did with cotton.

Shrimp. On January 27, 2005, the United States imposed an antidumping duty order on frozen or canned shrimp, and prawns from Brazil, decreasing imports from shrimp farmed in the poorer northeast portion of the country.

Beef and Chicken. U.S. sanitary certification for Brazilian chicken has not been approved, and for beef was only approved in 2005, subject to a TRQ.

U.S. Complaints Against Brazil.³⁹ The USTR lists a number of complaints against Brazil, ranging from cumbersome import administrative procedures to outright restrictions on certain imports. Of equal importance is the inability to make more progress in areas where the United States is most competitive such as protection of intellectual property rights and services trade.

High Tariffs. Between Brazil's higher average tariffs (especially on industrial goods) and Mercosul's CET (exacerbated by a surcharge from 1997 to 2004), Brazil's tariff regime hurts U.S. exports of agricultural products, distilled spirits, computer and telecommunications equipment.

Prohibited Imports. Restrictions apply to various consumer goods, with a safeguard measure currently issued against certain toys.

Intellectual Property Rights. Although Brazil has numerous IPR laws on the books, the USTR is critical of many and notes that enforcement issues are a serious problem.⁴⁰ There is a 5-6 year backlog in processing patent applications, and data confidentiality protection for pharmaceuticals is not covered by law. Brazil lacks copyright enforcement leading to significant piracy losses for U.S. businesses (particularly video and audio cassettes). Despite Brazilian attempts to rectify the problem with a new task force and other initiatives, it lacks the resources to tackle the problem fully at this point in time. Brazil, therefore, is reluctant to sign on to an FTA that contains enforceable IPR provisions. The United States held up review of Brazil's eligibility for benefits under the Generalized System of Preferences (GSP) because of concerns over piracy issues, but the United States decided against taking action in recognition of Brazil's attempts to address piracy. Still, Brazil acknowledges its piracy problem, realizing the implications for its own producers and tax revenues as well. The Brazilian Congress conducted a study on the issue in 2004,

³⁹ For Brazil's trade barriers, see United States Trade Representative. *2005 National Trade Estimate Report on Foreign Trade Barriers*. Washington, D.C. March 2005. pp. 30-37.

⁴⁰ USTR, *2005 National Trade Estimate Report on Foreign Trade Barriers*, pp. 33-37.

which noted that piracy constituted nearly 60% of music sales and that Brazil had failed to close legal loopholes and counteract the problem more effectively, including its lack of organizational capacity and resources.⁴¹

Onerous Licensing and Regulatory Requirements. Importers complain of the high costs associated with meeting business registration and other requirements in Brazil.

Sanitary and Phytosanitary (SPS) Barriers. The USTR argues that SPS restrictions, including those that apply to beef, the prohibition of poultry imports (also a reciprocity issue), and certain types of wheats from various U.S. states are unfounded.

Government Procurement. Brazil is not a signatory to the WTO Agreement on Government Procurement and there are multiple preferences given to local businesses.

Export and Financing Subsidies. Through various programs at the National Social and Economic Development Bank (BNDES), Brazil promotes the purchase of domestic equipment and machinery and helps finance export activities.

Services Trade and Investment. There are restrictions on industries such as audio visual, telecommunications, financial (insurance), and express delivery services. Brazil has expressed concern over investor-state provisions, standard language in U.S. free trade agreements, and possible U.S. reaction to some of its subsidized financing programs conducted under BNDES. Brazil has not signed a bilateral investment treaty with the United States.

Outlook

Brazil trades relatively little for an economy of its size and diversity and would benefit from trading more. It has embraced export promotion, which generates foreign exchange and can contribute to growth in economic output, but has shied away from deeper commitments to lowering barriers to imports, which are key to gains in productivity, per capita income, and development. This strategy is consistent with Brazil's short-term financing needs and its trade preferences, which are driven by a combination of macroeconomic, industrial, and foreign policy priorities.

For the United States, this presents a delicate policy conundrum because economic reciprocity may not be the only key to successful trade negotiations with Brazil. For example, even if significant progress could be made on agricultural issues in the Doha round, and Brazilian trade complaints could be ameliorated in bilateral working groups with the United States, Brazil may still choose not to liberalize areas where either it cannot easily fulfill the provisions of an FTA (enforcing protection of IPR), or where the United States has a distinct comparative

⁴¹ Federative Republic of Brazil. Chamber of Deputies. *Legislative Investigation Committee on Piracy (CPI) Report*. Brasilia, 2004. pp.127 and 267-269.

advantage or particular interest (industrial goods, services, investment). This has been made clear in statements by Brazilian officials and by formal trade negotiation positions.

To illustrate, in speaking on the FTAA, a former Brazilian Ambassador to the United States and noted trade expert wrote:

The Brazilian position is not merely a tactical reaction to the U.S. negotiating strategy regarding the so-called systemic issues. In fact, Brazil has a clear interest in preventing hemispheric disciplines on topics such as investment, intellectual property, government procurement, and services from curtailing its ability to formulate and implement public policies that are in its highest national interest.⁴²

This attitude is reinforced by evidence questioning the economic logic of Brazil's anti-FTAA position based on the U.S. preference for addressing subsidies in the WTO. For example, studies point out that ending agricultural subsidies would increase FTAA agricultural trade little compared to a far bigger gain for Brazil from eliminating tariffs.⁴³ Brazil seems to realize this on some level or it would not continue to offer the "4+1" market access talks as an alternative to the FTAA.

As such, U.S. trade negotiators may be frustrated because there is perhaps little they can do to nudge Brazil off its course of continuing to advance Mercosul, where the marginal gains from expansion are likely small, and pursuing selective priorities in the WTO, while leaving the FTAA to flounder indefinitely. Brazil may actually have more to lose, however, because as much as both countries could improve their economic well-being from greater trade liberalization, as a developing country, Brazil seems to have the most to gain from not only reducing foreign barriers to its exports, but unilaterally opening its economy further, particularly as part of completing its ongoing economic reform agenda.

⁴² Barbosa, Rubens Antonio. The Free Trade Area of the Americas. *Fordham International Law Journal*. February 2004. p. 1021.

⁴³ Salazar-Xirinachs, José M. Development Issues Posed by the FTAA. In Weintraub, Sidney, Alan M. Rugman, and Gavin Boyd, eds. *Free Trade in the Americas: Economic and Political Issues for Governments and Firms*. Cheltenham, Edward Elgar Publishing, Inc. 2004. p. 238. A similar conclusion is drawn for global agricultural trade as well, where some 80-90% of trade-distorting cost is attributed to tariffs rather than subsidies. Congressional Budget Office. *The Effects of Liberalizing World Agricultural Trade: A Survey*. Washington, D.C. December 2005.

Appendix 1. Brazil: Top 15 Exports and Imports

(calendar year 2004, \$ millions)

Export Product	\$ Value	Import Product	\$ Value
1. Soybeans	5,395	1. Fuels and lubricants	10,317
2. Iron ore	4,759	2. Chem./Phar. Intermed. goods	9,638
3. Motor vehicles	3,352	3. Intermediate parts	5,589
4. Soybean oil cake	3,271	4. Mineral products	5,068
5. Airplanes	3,269	5. Accessories for trans. equip.	4,905
6. Meat, chicken	2,494	6. Non-durable consumer goods	3,673
7. Iron/Steel semi finish	2,115	7. Farming, raw materials	3,473
8. Flat-rolled iron/steel	2,007	8. Industrial machinery	3,278
9. Motor vehicle engines	1,972	9. Office/Science equipment	2,679
10. Meat, bovine	1,963	10. Fixed equipment	2,528
11. Motor vehicle parts	1,961	11. Inedible farm products	2,213
12. Footwear	1,899	12. Parts, industrial capital goods	1,518
13. Coffee	1,750	13. Foodstuffs, intermediate	1,517
14. Cane sugar, raw	1,511	14. Pharmaceutical products	1,454
15. Tobacco	1,380	15. Accessories for indust. mach.	1,065
Subtotal	39,098	Subtotal	58,915
% of Total Exports	40.5%	% of Total Imports	93.8%

Data Source: Boletim do Banco do Brasil, September, 2005.

Appendix 2. U.S.-Brazil Merchandise Trade
(\$ millions)

Year	U.S. Exports	U.S. Imports	U.S. Trade Balance	Trade Turnover	% Growth in U.S. Exports	% Growth in U.S. Imports
1992	5,751	7,609	-1,858	13,360		
1993	6,058	7,479	-1,421	13,537	5.3%	-1.7%
1994	8,102	8,683	-581	16,785	33.7%	16.1%
1995	11,439	8,833	2,606	20,272	41.2%	1.7%
1996	12,718	8,773	3,945	21,491	11.2%	-0.7%
1997	15,915	9,625	6,290	25,540	25.1%	9.7%
1998	15,142	10,102	5,040	25,244	-4.9%	5.0%
1999	13,203	11,314	1,889	24,517	-12.8%	12.0%
2000	15,320	13,853	1,467	29,173	16.0%	22.4%
2001	15,880	14,467	1,413	30,347	3.7%	4.4%
2002	12,376	15,781	-3,405	28,157	-22.1%	9.1%
2003	11,211	17,910	-6,699	29,121	-9.4%	13.5%
2004	13,837	21,160	-7,323	34,997	23.4%	18.1%

Data source: U.S. Department of Commerce.

Appendix 3. U.S.-Brazil Services Trade
(\$ millions)

Year	U.S. Exports	U.S. Imports	Trade Balance	*Trade Turnover	% Growth in U.S. Exports	% Growth in U.S. Imports	% of Total U.S. Trade
1992	2,500	688	1,812	3,188	na	na	1.2%
1993	2,944	744	2,200	3,688	17.8%	8.1%	1.3%
1994	3,732	917	2,815	4,649	26.8%	23.3%	1.5%
1995	4,994	1,176	3,818	6,170	33.8%	28.2%	1.9%
1996	5,208	1,403	3,805	6,611	4.3%	19.3%	1.8%
1997	6,408	1,775	4,633	8,183	23.0%	26.5%	2.1%
1998	6,620	1,962	4,658	8,582	3.3%	10.5%	2.1%
1999	5,641	1,726	3,915	7,367	-14.8%	-12.0%	1.6%
2000	6,309	1,953	4,356	8,262	11.8%	13.2%	1.7%
2001	5,826	1,856	3,970	7,682	-7.7%	-5.0%	1.7%
2002	5,005	1,723	3,282	6,728	-14.1%	-7.2%	1.4%
2003	4,795	1,841	2,954	6,636	-4.2%	6.8%	1.3%
2004	4,997	1,913	3,084	6,910	4.2%	3.9%	1.4%

Data Source: U.S. Department of Commerce. Bureau of Economic Analysis (BEA).

* Trade turnover = total trade or exports plus imports.

Appendix 4. U.S.-Brazil Foreign Direct Investment
(in millions of U.S. dollars, historical cost basis)

Year	U.S. FDI in Brazil	% Change	Brazil FDI in U.S.	% Change
1993	16,772	—	726	—
1994	18,400	9.7%	712	-1.9%
1995	23,706	28.8%	864	21.3%
1996	28,699	21.1%	689	-20.3%
1997	35,727	24.5%	698	1.3%
1998	37,802	5.8%	609	-12.8%
1999	37,184	-1.6%	735	20.7%
2000	36,717	-1.3%	882	20.0%
2001	32,027	-12.8%	596	-32.4%
2002	27,598	-13.8%	997	67.3%
2003	31,741	15.0%	667	-33.1%
2004	33,267	4.8%	1,286	92.8%

Source: U.S. Department of Commerce. Bureau of Economic Analysis (BEA).

Note: historical cost data measures the stock of FDI reflecting prices at the time of the investment.