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Assessment of the relative virtues and evils of regional integration as opposed to allegedly more elusive multilateral liberalization has been a major theme in recent work in trade policy. It is rare that such assessments acknowledge that specific national interests in particular mixes of regionalism and multilateralism will vary significantly depending on trade structures and trade policies. This paper, which is mainly concerned with trade relations, seeks to evaluate the arguments in favor and against the economic integration of the Brazilian economy to other economies in the hemisphere and how Brazil-US relations could be affected by alternative integration scenarios. This could result from either concrete developments under the Enterprise of the Americas Initiative (EAI) or from the creation of effective docking conditions for the absorption of new members in the context of the North American Free Trade Area (NAFTA).

The wide differences in the speed of economic reform as well as in the success of macroeconomic stabilization in different Latin American economies is now obvious even in a cursory comparative analysis. Brazil's laggardness in introducing structural reform or the ineffectiveness of efforts to control inflation invalidate any unqualified assertion on the reversal of the economic climate in Latin America or the stable improvement of relations with the US. These contrasts are rooted in the past. It is thus difficult to assess Brazilian current policies and their likely implications on bilateral relations with the US without a relatively long perspective which includes the abrasive 1980s. As it becomes increasingly likely that such bilateral frictions will return such perspective becomes even more relevant.

The paper begins by considering the impact of the economic crisis of the 1980s on Brazil-US relations and in particular the significant deterioration in bilateral and multilateral economic relations affecting trade matters. Then it is examined how from 1988 onwards these frictions were reduced by domestic economic reform, specially of trade policies, and the adoption of a more positive approach to multilateral trade negotiations in the GATT. Alternative implementation scenarios for regional integration initiatives involving Latin American countries and the United States and Canada, such as the NAFTA and the EAI, are assessed and likely impacts on Brazil are evaluated. The conclusion considers how the increased importance of regional integration is likely to affect Brazil-U.S. relations.

1. Brazil-US Economic Relations in the 1980s

There were several significant irritants of Brazil-US relations inherited from the 1960s and 1970s². The policy of close political alignment with the US which prevailed in the period immediately after the 1964 coup led to a reversal of stances in international fora such as in the cases of reservations placed on some of the principles included in the Final Act of the UNCTAD Geneva Conference of 1964 or of participation of Brazilian troops in the intervention in the Dominican Republic in 1965. After 1967 the Brazilian stance started to change. In the negotiations leading to Treaty for the

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

Prohibition of Nuclear Weapons in Latin America signed at Tlatelolco, Mexico, in 1967, Brazil did not waive the requirement of full ratification as a precondition for effectiveness. The Nuclear Non-Proliferation Treaty of 1968 was also not signed, national security interests serving as the rationale for the maturing of policies which tended to increasingly reassert Brazil's autonomy in relation to the US.

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

The sharp rise of oil prices after 1973 tended to reinforce, rather than defuse, latent or overt bilateral frictions, given Brazil's dependence on imported oil. In the nuclear field Brazil signed in 1975 with the Federal Republic of Germany an Agreement Concerning Cooperation in the Field of the Peaceful Use of Nuclear Energy which involved the construction of several nuclear power stations and the transfer of sensitive technology in the fields of uranium enrichment as well as of production and reprocessing of nuclear fuels. This move marked a merge of economic - that is prospectively energy-saving - arguments with those which underlined the usefulness of the agreement from a more political point of view, specially so in connection with the bilateral relations with the US in view. Indeed, the Carter administration abandoned the previous administration's emphasis on Brazil-US relations as Brazil was an emerging regional power center. Not only it strongly reacted against the Brazil-Germany Nuclear Agreement but also pressed the Brazilian government during the Geisel administration to improve its poor human rights record. Resulting frictions led to the denunciation of the long-standing agreement on military cooperation.

Brazil adopted an increasingly aggressive stance in its bilateral relations in the Middle East and Africa, trying to assure long-term oil supply and to use oil purchases as a lever to increase exports through countertrade deals. Since these deals entailed a mushrooming of military equipment exports, it is not surprising that the domestic coalition backing these new policies gained considerable strength. Partly because of oil considerations, but also as a natural backlash, given its formerly stand in favor of Portugal in its colonial conflicts in Africa, Brazil adopted a position of high profile specially in Southern Africa, reasserting the independence of its foreign policy in relation to the US.

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

Brazil was not very active in the GATT before the Tokyo Round. Towards the end of the Round, however, in the negotiations of both the so called Framework group and of the GATT codes, Brazil had a more active role³. The negotiations in the so called Framework group⁴ originated from a Brazilian proposal which included the provision of a legal basis for GSP which would entail the consolidation of preferences and establish liability to compensation in the event they were withdrawn and more flexibility in the use of article XVIII for balance of payments purposes⁵. Negotiations resulted in the consolidation of the derogation which legalized non-reciprocity based in special and differential treatment⁶.

The US, dissatisfied with what was seen as consistent free riding by developing countries, emphasized the importance of negotiating specific codes which attempted to limit MFN treatment to signatories. The code on subsidies was the most important code from the point of view of Brazilian interests to be negotiated in the Tokyo Round. For code signatories the application of compensatory duties should be based on proof of injury to domestic industries. Brazilian negotiators yielded to US pressures through the Brazilian Ministry of Finance and Brazil agreed to the gradual removal of tax credits tied to export performance as well as to freeze the level of export subsidies⁷. Brazil was the first developing country to sign the code on subsidies. Other developing countries which followed as signatories made less significant concessions as is clear in the vague undertakings entered by India and Pakistan⁸.

The marked deterioration in Brazil-US economic relations in the 1980s involved both financial and commercial links. In the financial field, however, frictions were of a more diffuse nature, frequently involving the intermediation of the International Monetary Fund and the World Bank and also affecting commercial banks other than those from the US. The main exception was an incident due to Brazil's great financial vulnerability in the end of 1982 which led to a sudden weakening of its bargaining position. When the need for a US Treasury bridge loan was most pressing, the US government successfully pressed Brazil to soften its stance of resisting the inclusion of the so-called "new themes" in the GATT Ministerial Declaration. In 1987 US-Brazil financial relations probably reached their nadir since the early 1960s as Brazil declared a foreign debt moratorium. The renewed moratorium in 1989 was less abrasive as it was clear that some of the political constraints to a normalization of the debt position could be removed by the first free Presidential election in 29 years and some trade liberalization was already occurring.

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

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

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

⁶ See Winham (1986), p.274 ss.

⁷ See Lima (1986), pp. 330-336.

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

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

It is notoriously difficult to assess the protection implications of antidumping as well as of subsidy countervailing duty actions due to their dissuasive impact. Compared to other countries which are not developed (both developing and centrally planned economies), Brazil has been an important target for AD initiations in the US in 1982-86 and less so in 1988-90, reflecting the overall incidence of such actions. Other importantly affected countries in this group were China, Taiwan, South Korea and South Africa. Brazil has also faced many CVD actions mainly between 1982 and 1986: in three of these years it led, or co-led, the list of affected countries. Other affected countries besides those also mentioned in relation to AD actions were Mexico and Venezuela.

AD and CVD actions have affected a wide range of Brazilian exports of which the most important were iron and steel products, chemical and petrochemical products, orange juice, textiles and footwear⁹. Brazilian steel and iron exports to the US have been affected by VERs from 1984 to early 1992. Similarly, Brazilian exports of textiles and clothing are constrained by export limitations negotiated bilaterally under the Multifibre Arrangement umbrella.

Brazil was less affected by AD and CVD actions in the second half of the 1980s, at least in part because of the use of other protectionist instruments. Thus Brazil has faced US actions under Sections 301 of the Trade Act of 1974, as amended, "Super 301" and "Special 301". Of 87 of such initiations between 1975 and October 1991, 6 were against Brazil (the Republic of Korea faced 8 initiations, Taiwan and Argentina 5 and India and China 4)¹⁰. Brazil was the only developing country to suffer retaliation from the US under Section 301, as in October 1988 action was taken by the US imposing tariffs of 100% on Brazilian paper, pharmaceutical and electronic products entering the US market. This resulted from a complaint by the Pharmaceutical Manufacturers Association that the Brazilian intellectual property legislation did not provide adequate protection for US patents. The other important 301 case affecting Brazil was related to the informatics policy, in particular software legislation. The case was initiated by the USTR in 1985 based on grievances concerning access to the Brazilian software market, protection of intellectual property in relation to software and hardware and administrative procedures adopted by the Brazilian authorities in the informatics sector. It was only

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

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

terminated in October 1989 after changes in the relevant Brazilian policies. Brazil was designated in May 1989 as one of the priority countries for application of retaliation under Section 301 in relation to the Brazilian import licensing system.

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

There were in the 1980s many instances of consultations and panels of Brazilian interest in the GATT, both as a complainant and as a defendant¹¹. But by very far the most significant issue of Brazilian bilateral interest to be discussed in GATT in the 1980s was related to already mentioned retaliatory action taken by the US in 1988, by imposing tariffs of 100% on selected Brazilian paper, pharmaceutical and electronic products entering the US market. It was perhaps the most extreme demonstration of how far the US Administration was willing to go in its policy of keeping pressure on Brazil to improve access to the Brazilian market as well as to assure enforcement of stricter intellectual property legislation. Brazil asked for the establishment of a panel to consider the questions of principle involved in the American action. The US foot dragged but a panel was eventually established early in 1990. There was no agreement on its terms of reference as the US insisted that the substantive Brazilian legislation should be examined while Brazil centered its case on the conflict between the American action and GATT rights and obligations. Terms of reference limited the panel to examination of compatibility of the action with GATT. The US faced much criticism in the GATT as the action was not preceded by any effort to settle the dispute using GATT machinery.

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

¹¹ As a complainant: the Brazil-Spain 1980 panel on the tariff treatment of unroasted coffee, the consultations held in 1982 on the EC sugar export refund system in which Brazil was one of the ten countries involved, the 1986 Brazil-US consultations on US tariff on ethyl alcohol, the protracted Brazil-US dispute on CVD duties charged on non rubber footwear and the 1988 Brazil-US consultations on the unfavorable impact of US subsidies under the Export Enhancement Program on Brazilian exports of soya bean oil. As a defendant: the US 1983 complaint on Brazilian violation of Code of Subsidies in relation to poultry exports, the US-Brazil 1987 aborted consultations on restrictions on micro electronic products and the US 1989 complaint on the Brazilian quantitative import control regulations. For data see GATT, GATT Activities, several issues as well as GATT (1989) and (1992).

¹² For the evolution of Brazilian stance in the GATT see Abreu (1992). For countries without much bargaining power it

With the inclusion for all purposes of the "new themes" in the Uruguay Round negotiations agenda in Punta del Este (two tracks and all) in 1986, and partly due to internal developments, Brazil after 1987 started to move towards a more active role as a demandeur. It was fortunate that Brazil had a credible, and naturally available, fall back position as an initial, but far from enthusiastic, member of the Cairns group of fair (and not so fair) traders in agricultural temperate products. From 1987-88 Brazil started to play an increasingly important role in agricultural negotiations and in other negotiating groups. As agriculture became the main stumbling block to progress in the round, Brazil played an important role in the GATT Mid Term Review held in December 1988, in assuring support first for the stand by the Latin American members of Cairns, then by the Cairns group, endorsed by the US, of conditioning results in all negotiating groups to progress in agricultural liberalization.

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

Domestic reform since 1990 played an extremely important role in drastically reducing bilateral Brazil-US frictions. Prompted by a mixture of disappointment with the performance of the economy, deepening of the fiscal crisis, wear and tear of interventionist policies and by international pressure, the Brazilian policy of export promotion and import repression had already slowly started to change in 1987. In 1987-89 the list of products affected by de facto import prohibitions was progressively reduced, other non tariff barriers removed and tariff rates reduced. The level of tariff protection remained quite substantial and non-tariff barriers formidable. The average nominal tariff was in the region of 35% at the end of 1989 (maximum rate 85%). Effective rates of protection were mostly between 30 and 60% but reached extreme values of more than 150% (transport equipment).

It was, however, from March 1990, when a new administration took office, that there was a significant shift in economic policy. New policies were devised and implemented covering price stabilization, foreign debt renegotiation and structural reform. Almost from the start, however, the new administration credibility was marred by its clear ambiguity between reform and the continued adoption of long established corrupt practices. It was difficult to be at the same time against legal rent-seeking behavior and engage in, or condone, openly corrupt practices.

The failure, after several attempts, to achieve price stabilization has perhaps tended to obscure concrete achievements in relation to the other economic objectives such as debt renegotiation and structural reforms. Whether these achievements can be sustained with the deterioration in the political situation which led to the impeachment of President Collor remains in doubt.

became increasingly clear that it would be impossible to try to apply the equivalence of concessions rule. It became increasingly common to justify the advantages of liberalization based on standard efficiency grounds for "small countries". It is, however, less common to find acknowledgement that efficiency rules are not necessarily coherent with the commercial policy of contracting parties with negotiating clout.

Since early 1991 much progress has been made in relation to the foreign debt renegotiation. After an agreement was reached with the IMF on macro economic adjustment in January 1992, agreements followed with the Club of Paris on foreign official credits in March 1992 and with the private banks in July 1992. By the end of March 1993 more than 95% of the creditor banks had accepted the agreement albeit with a mix of options out of line with initial government expectations.

Persistence of a monthly inflation rate in the region of 25% requires another renegotiation with the IMF involving not only redefinition of targets but also the final approval of a significant fiscal package. The clear reluctance by the Franco administration to consider as politically acceptable the continuation of economic recession required by the implementation of a new stabilization program is an indication of the persistent difficulties ahead. These conditions have made it difficult to attract direct foreign investment in spite of a significant increase in capital inflows prompted by the very high interest rates adopted to avoid hyperinflation.

The program of structural reforms introduced by the Collor administration included elements of privatization, deregulation and trade liberalization. Privatization has proceeded somewhat slowly due to law suits against privatization, constitutional restrictions of privatization in sectors such as oil exploration, refining and transportation, and the emphasis on a transparent market-oriented process. It is indeed remarkable that during the Collor administration the process was on the whole free from accusations of corruption in spite of wide differences of opinion on its conception and implementation, in particular concerning the almost exclusive use of several types of heavily discounted government paper. The privatization program has been quite successful if account is taken of constraints. Usiminas, the largest Brazilian steel mill (output of 4 million tons/year), and Copesul, an important petrochemical upstream plant (sold for US\$ 1.3 billion) were the most important privatization cases. Foreign capital, however, has not shown interest in the privatization effort, an indication of lack of confidence in the success of price stabilization efforts. Under President Franco privatization policies have become more centralized and more vulnerable to discretionary decisions.

Deregulation affecting domestic activity in practice mostly affected the pricing of inputs such as steel and fuels subjected in the past to the distortions of strictly enforced national prices¹³. There is much to be done in deregulation but it is unlikely that Congress approves sufficiently liberal legislation on most relevant issues. After Collor's impeachment new legislation was introduced on the deregulation of labor supply arrangements in ports and on increased competition in the use of port facilities.

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

¹³ Foreign trade deregulation was significant but is treated below under trade liberalization.

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

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

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

The elimination of frictions with the US generated by trade relations bilaterally and multilaterally was a consequence of the shift towards liberalization. The removal of import licensing extinguished the basic reason for Brazil's designation as a priority target. Similarly, undertakings by the Brazilian government to propose intellectual property legislation which should considerably improve protection and allow process patenting made possible the removal of "retaliatory" tariff rates by the US and eventually the withdrawal by Brazil of complaints in the GATT. These changes were still being considered by the Brazilian Congress. Changes in the legislation concerning informatics answered to a large extent US complaints in the sector¹⁴. AD and CVD actions became less frequent for a while but the end, in early 1992, of the arrangements which limited the supply of Brazilian steel products in the US market led, as would be expected, to a number of anti dumping initiations.

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

¹⁴

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

More recently, minor problems emerged in the GATT. The old Brazil-US dispute on CVDs on non-rubber footwear Brazilian exports has flared up as Brazil has blocked, with support of other contracting parties, the adoption of the panel's report in favor of the US. Similarly, the US blocked, at least temporarily, Brazil's somewhat odd attempt to obtain GATT's approval of its Mercosul arrangements under the Tokyo Round Framework agreement - which assures developing countries special and differentiated treatment - rather than under the theoretically more exacting, but notoriously laxly applied, Article XXIV. In mid-October 1992 Brazilian commercial policy was for the first time assessed under GATT's Trade Policy Review Mechanism with quite a favorable outcome as there was a full recognition of the liberalization efforts undertaken in the recent past.

3. New Directions in Economic Integration in Latin America

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

Regional economic integration has been hailed by many as a strategy more likely to further trade liberalization than multilateral trade negotiations conducted in the GATT. It is, however, not easy to show the unqualified inherent economic advantages of taking regional economic integration as a road leading to a global market unhindered by obstacles to the free flow of goods, services and factors¹⁵. Such advantages are likely to vary substantially depending on characteristics of different economies. Arguments based on political expediency to show the advantages of regionalization over globalization seem much more effective and are, of course, much helped by the lack of results in the GATT negotiations. Other frequent arguments used to underline the advantages of regional integration stress that FTAs assure access to markets which would otherwise further restricted and lock-in liberalization commitments protecting them from revision in the future. One feels that the advantages of locking-in liberalization provided by GATT tariff bindings, specially in the case of small economies, have been somewhat disregarded.

The use of the theory of collective action has been suggested to explain why a small number of countries interested in regional integration, with more apparent sectoral interests, are more likely to succeed than a large number of countries aiming at the successful conclusion of multilateral trade

¹⁵ See on this Lawrence (1991) and, specially, Bhagwati (1992) who stresses the conflicts between regionalism and multilateralism. See also Lawrence (1991) and Fishlow and Haggard (1992) for views more inclined to see the advantages of regionalism.

negotiations in relation to which benefits are more widely spread. This view surely underestimates the importance of differences in size and/or bargaining power among GATT's contracting parties. The theory of collective action is more relevant to explain the present deadlock in the GATT which is essentially due to EC objections to the extent and pace of agricultural liberalization¹⁶.

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

It is still reasonable to expect that the Democrat victory in the US Presidential elections will not substantially affect the NAFTA agreement even if ratification by the US Congress requires the creation of trilateral councils to promote and enforce acceptable minimum environmental or labor standards. The change in administration is more likely to affect US policy on the tempo and comprehensiveness of efforts related to the extension of NAFTA to other countries.

The NAFTA Agreement is extremely complex, with many direct and indirect implications for Brazilian interests. In relation to trade in goods NAFTA provides for the progressive elimination of all tariffs. In most cases tariffs will be phased out immediately or in annual stages over a period of 5 to 10 years. For specially sensitive products this will be extended to 15 years. It is important to analyze different scenarios concerning NAFTA, particularly in relation to the treatment accorded to access of products most affected by US protectionism and likely to be of special Brazilian interest such as sugar, orange juice and certain manufactures.

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

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

¹⁶ See CEPR Bulletin, 50-51, April/June 1992, p. 18.

the US are significant. Sugar TRQs will be applied in the sixth year after NAFTA takes effect¹⁷. After 15 years all restrictions on sugar trade will have been abolished except certain US provisions on sugar re-exports. To increase its quota Mexico will have either to increase productivity or shift to the use of corn-based sweeteners in its substantial soft drink industry so as to release sugar for export. Special agricultural safeguards can be applied during the first 10 years.

While some Latin American economies depend very importantly on North American markets - Mexico (more than 70%)¹⁸, Venezuela (around 55%) and Colombia (around 45%) - those are less important for Brazil (less than 30%) and Argentina. These other large Latin American economies depend on European markets (25-30%) as well as on markets in Eastern Europe and other developing economies (specially Argentina). Import commodity structures, on the other hand, to a large extent define the origin of imports. Oil dependent economies such as Brazil purchase a lower proportion of its imports in developed countries and a larger share in West Asia. In 1991 less than 20% of total Brazilian exports were purchased by the US, while US imports corresponded to 23.6% of the Brazilian market.

Table 1 presents 1989 shares of Brazil, Mexico, other developing American countries and other suppliers in total US imports of products which are of relevance for Brazil. Products included in the list correspond to more than 79% of total Brazilian exports to the US in 1991. There is no competition between Brazil and Mexico in the US markets for iron and aluminum ores, pulp and waste paper, gasoline, and, to a certain extent, footwear. Such Brazilian exports to the US were of US\$ 2,070 million in 1989, that is, 23% of Brazilian exports to the US. In most other products there is competition between Brazil, and Mexico for the US market. Other Latin America and Caribbean countries also compete with Brazilian products for the US market but their exports of orange juice, pulp and waste paper, and all manufactures with the exception of electrical machinery, clothing, footwear and scientific equipment to the US are insignificant so that 44% of Brazilian exports to the US do not compete with those from Latin American and Caribbean countries other than Mexico.

¹⁷ Brazilian 1992 sugar quota in 1992 is of 169,084 tons, equivalent to about US\$ 75 million of exports.

¹⁸ 1988 data unless stated otherwise.

Table 1

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

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

Among the largest Latin American countries Brazil was in 1986 the most affected by tariffs and by both tariffs and nontariff barriers in the US. Incidence of all NTBs was marginally lower on imports from Brazil than on those from Argentina and Mexico, but Brazilian exports were relatively more affected by hard core NTBs (quantitative restrictions and flexible import fees)¹⁹. Tariffs faced by Brazilian exports are generally low (below 5%) except in the case of tobacco, copper and tin manufactures where they varied between 10 and 17%. Some of the most important Brazilian exports to the US, however, face significant nontariff barriers: orange juice (excise), sugar (quota), steel products (VERs in the past, now CVD actions), textiles and clothing (under the MFA).

Estimates of static trade diversion caused by NAFTA suggest that total trade diverted would be only about US\$ 441 million of which no more than US\$ 35 million originating in Latin America. Brazil would be by far the largest loser in Latin America with diverted exports of US\$ 18.3 million of which roughly half of food and agricultural exports and half of manufactures. Trade diversion would be thus dwarfed by the expected income effects of NAFTA generated by a comprehensive liberalization program which goes much beyond trade in goods liberalization²⁰. Trade diversion of Brazilian exports is zero for many products either because tariff rates in the US are zero or Mexican exports to the US do not exist. This is the case of crustaceans, nuts, coffee, pulp and waste paper, iron and aluminum ores, rubber products and gasoline. Most of trade diversion affects orange juice since Brazil is the dominant supplier of the US and protection is high in the US. But even then trade creation due to NAFTA is small as Mexico is not an important exporter to the US; trade diversion is thus also quite small. It is also unlikely that footwear exports are substantially diverted as levels of protection are low with tariffs around 5% and no recent NTBs.

For most products, however, the potential trade diversion of NAFTA is likely to be far more significant than the static one. Preferential tariff treatment in the US shall stimulate investment in Mexico both by US and other countries' producers of goods now protected by barriers to trade in the US. Incentives to new investment would be relatively more important in sectors relatively more protected. The main products of Brazilian interest which in principle could be substantially diverted, but not before a time lag of five or more years, are orange juice, steel products, sugar and textiles. In most cases Mexico will have difficulty in raising present productivity standards to levels required to substantially increase its market shares in the US.

In June 1990 President Bush announced the Enterprise for the Americas Initiative based on three pillars: trade integration in a free trade arrangement, foreign investment promotion and foreign

¹⁹ See Erzan and Yeats (1992b), tables 5 and 7.

²⁰ Erzan and Yeats (1992b), box 1. Assessment of NAFTA trade diversion affecting Brazilian products is in line with findings on Kreinin-Finger "export similarity measures" of pairs of developing Latin American countries which placed the Brazil-Mexico pair in the top position, that is as the pair of countries with the most similar export structure to the US, see Erzan and Yeats (1992a), box 3.

debt reduction. Potentially the trade integration proposals are likely to be more significant than those on investment and debt. Liberalization of foreign investment regimes is to be fostered through two IDB-administered programs: a limited technical assistance program and the constitution of a multilateral investment fund. The reduction in debt service is unlikely to provide significant relief, specially so in the case of Brazil: the Overseas Development Council estimated in US\$ 287 million the likely debt service relief over 1991-1994. While Japan has contributed to the multilateral investment fund it is difficult to see the EC enthusiastically cooperating in the provision of additional funds to an initiative which is clearly a counterbalance its regional integration initiatives. The trade element of the Initiative has in any case been clearly dominant as the NAFTA negotiations have successfully proceeded.

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

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

Estimates of the impact of the preferential removal of trade barriers in the US market on exports of Latin American countries suggest that export gains are heavily concentrated in Mexico and Brazil. Of a total export expansion of US\$ 3,208 million, US\$ 1,640 million would benefit Mexico and US\$ 947 million Brazil. In fact the 14.2% expansion of Brazilian exports is higher than the 9.6% estimated increase in Mexican exports because energy products -which enter practically duty free in the US - are an important share of total Mexican exports to the US. Total Latin American exports would increase 8% while exports from countries such as Chile, Peru, Bolivia and Ecuador would be less than 3% higher. These estimates refer to exclusive FTAs of each Latin American country with the US but they would not be significantly altered in a scenario where all Latin American countries were integrated to the US but not between them²¹.

Incentives to integrate, however, may have little relation with static trade gains. Integration with the US may be seen as the best insurance against new trade restrictions in the US or as the most

²¹ See Erzan and Yeats (1992b), table 8. There no available estimates of the impact of liberalization among Latin American countries on trade flows.

effective form of binding results of trade reform or as part of a policy package to attract foreign investment.

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

Brazil benefits in entering a FTA with the US would be relatively important given the value of its exports to the US, that price elasticities of demand for its exports are high and tariffs and NTBs significantly affect its exports to the US. Brazilian gains are limited by the diversification of its export markets since the share of exports to the US is lower than in most other Latin American countries. Exports to the US have been losing importance since the record year of 1984 when the US market regained the importance of the early 1970s (see Table 2). From 1984 to 1990 Brazil lost more than one third of its share of the US market. The collapse continued since 1990: in 1991 US exports were less than 20% of total exports.

Table 2
Brazil: Exports to the US, 1980-1990

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

Sources: computed from IMF and Brazilian Central Bank data.

Disaggregated shares of Brazilian imports into the US markets (see Table 3) indicate that it is the relative decline of food product imports to US and, to a lesser extent (by a factor of about 10 if compared to food), of manufactures excluding machinery, which explains the decreasing overall importance of Brazilian exports in the US market. Part of this is explained by the fact that food imports fell from 7.11% of total US imports in 1984 to 5.75% in 1989. But Brazil also lost market share in the US, specially in food and live animals (SITC 0, which includes coffee and orange juice): it fell from 12.6% to 7%. This results from a gradual dislocation of Brazilian coffee exports by those from other origins and from fluctuations in the US domestic production of orange juice.

Table 3

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

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

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

A FTA with the US would have consequences on Brazilian imports and domestic production of competitive products similar to those entailed by a multilateral liberalization. Since the Brazilian tariff is high, and given the diversification in the origin of imports, trade diversion of other suppliers would be considerable. It is to be expected that suppliers such as the EC could, in retaliation, increase difficulties faced by Brazilian exports to its markets. It is also likely that relatively inefficiently produced imports from the US would divert efficient producers if no other developed country had preferential access to the Brazilian market. Trade creation in Brazil would also be relatively more important since the tariff is higher than in the US and adjustment costs related to the displacement of domestic producers by imports are likely to be substantial²².

²² See Fritsch (1989).

The importance of the Brazilian market cannot be underestimated even if Brazil's mediocre macro economic performance, combining high inflation and fall in GDP per capita since the early 1980s, painfully contrasts with the improvement of economic conditions in other Latin American economies such as Chile, Mexico and Argentina. Brazil is a relatively closed economy partly because it is of continental size. Even so, its market for imports compared to those of other Latin American economies is second only to Mexico's (see Table 4 below) in which the US market share is already very high. Even if, say, Chile's import/GNP ratio is 5 times the Brazilian import/GNP ratio, the sheer size of the Brazilian GNP, about 15 times the Chilean GNP, makes the Brazilian import market about three times the size of the Chilean market. Moreover, the size of the domestic market is increasingly relevant, even with relatively low ratios of openness, as issues directly or indirectly related to foreign investment, such as services and intellectual property, tend to gain in importance if compared to traditional trade issues.

Table 4

Openness and Size of the Largest Latin American Economies, 1990

	Exports/GNP	Imports/GNP	Total Trade/GNP	Total GDP (Brazil=100)
Argentina	.138	.046	.184	22.2
Brazil	.078	.056	.134	100
Chile	.335	.274	.609	6.4
Colombia	.166	.137	.303	10.1
Mexico	.124	.131	.255	53.3
Peru	.130	.128	.259	6.2
Venezuela	.341	.126	.468	12.5

Source: computed from World Bank data.

Remaining outside either a "hub and spoke" trade integration of the Americas, or a WHFTA with many members, or without a preferential arrangement when most other Latin American countries have one, would foster potential trade conflicts with the US. Brazilian exports are likely to be diverted by the US in Latin America given the high share of manufactures in exports to other Latin American countries and the share of Latin American exports in total Brazilian exports.

Alternative scenarios on the timing and scope of economic integration of course depend crucially on what is going to be US policy after NAFTA is concluded. One alternative, still more likely under a Democrat Administration, is that while NAFTA is being digested, that is, while the initial dislocations produced by trade liberalization are faced politically, the US would not be keen to consider further integration concrete initiatives with a relatively big Latin American economy such as Brazil, either through bilateral FTAs or actual use of NAFTA docking provisions. This will be so in

spite of the significant advantages to be gained by the US if its products benefit from preferential access to the Brazilian market. An additional independent deterrent to the US is a continuation of the "sick man of Latin America" syndrome in Brazil as the Franco government in any foreseeable constitutional format proves, like its predecessors, unable to create the political conditions required by successful price stabilization and a return to economic growth. Moreover, given the similarities of economic structures in Brazil and Mexico, as already mentioned, it is to be expected that Mexico will tend to resist Brazil-US preferential trade arrangements as previous benefits gained in the US would be eroded. Integration sequencing is likely to be to some extent defined by the resistance to widening integration by previously integrated partners.

The alternative scenario is determined by US willingness to concretely go ahead with WHFTA because its political significance and perceived economic gains outweigh difficulties caused by perceived costs related to domestic dislocations and specially unemployment. Attention would tend naturally to center on Brazil which will then face a difficult situation. Its interests are multilateral and systemic and not strictly regional. To proceed with integration with the US would further strain the domestic sectors which are already adjusting to a significant trade liberalization program. Tariff rates, however, are, and will remain after the last round of reductions in mid-1993, above those in other Latin American countries so that trade diversion will significantly affect other suppliers with a risk of retaliation in the case of some of them, in particular the EC.

The fact that Argentina and Brazil are partners in the Mercosul in principle fosters economic integration between Brazil and the US given Argentina's considerable enthusiasm with integration with the US, even if its concrete economic foundations appear to be somewhat mysterious. But there are powerful counterbalancing factors. The most important are those linked to the lack of perceived net economic advantage for Brazil in such an integration move with the US. This balance of costs and benefits is likely to be worsened by the potential dislocation of Brazilian exports by US products in the Argentinian market. Recognition of such difficulties have prompted Brazil to proceed in relation to the Initiative for the Americas on a "4+1" basis, that is Mercosul and the US, rather than bilaterally.

There are also political limits to Argentinian initiatives which counter Brazilian concrete interests. Interest in the two big partners in Mercosul was from the start not symmetrical, given the size of their markets. Political arguments had great weight in explaining the Brazilian stance. Argentina's recent increase in import duties in an attempt to reduce trade imbalances generated by overvaluation of the exchange rate has been accompanied by criticisms of Brazilian macroeconomic policies as an important reason for the import surge. While Brazil's inability to control inflation is a major stumbling block in the path of Mercosul this should not hide the substantial distortions of Argentinian foreign exchange policy. One of the very few acceptable features of economic policy in Brazil is that the exchange rate is about right. Argentina's scope to play the political card seems thus nearly exhausted. In Argentina itself, those lobbies favoring integration with the US, even at the cost of jettisoning Mercosul, seem to be rapidly gaining strength.

Consequences on investment flows of regional arrangements such as NAFTA and WHFTA are bound to vary dramatically depending on specific conditions. It is reasonable to expect in principle that investment from the US would particularly benefit relatively larger countries such as Mexico and Brazil. It is also likely that, at least initially, the drive for economies of scale and scope will benefit those countries where there already exists a smaller number of larger plants. This is specially relevant in the case of multinational enterprises. The theoretically increased attractiveness of foreign investment from other sources than the US could be reversed by clauses such as those on rules of origin. The stiff rules of origin requirements defined for the automotive industry under NAFTA, for instance, will contribute to further reduce the already limited attraction of investment in Mexico for Japanese firms. But such general arguments must be qualified by those related to comparative macroeconomic environments. So Brazil's present capacity to attract to such investments is very limited in spite of its structural advantages of size²³.

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

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

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

But different trends concerning economic policy and structural reform in Brazil are of paramount importance to analyze the future of Brazil-US economic relations. There is no new fact after President Franco took office which would support any optimism on the ability of the government to reduce inflation as a precondition to a return to growth. Quite on the contrary, everything points out to a return of policies which had seemed doomed in 1990 such as those subsidizing middle class housing or controlling prices. On the other hand, it is not unlikely that trade liberalization is frozen or even reversed in special cases. Other structural reforms such as privatization have already been adversely

²³ See Vernon (1992), p. 25.

affected. One extremely serious, but frequently missed, consequence the institutional crisis which led to President Collor's impeachment for corruption is that structural reforms introduced by the previous administration are being singled out, specially by vested interests, as being somehow tainted because they were proposed by the impeached President.

In such a climate there is no credible role for strategic trade policies as decision-making would face all well known difficulties, underlined by the experience of costly past errors on targeting and pace, in a situation of sharp deterioration of administrative capacity in the Federal government. It is unlikely that the timid advances in political transparency would compensate these unfavorable trends. If this scenario prevails Brazil's credibility will continue to reflect its economic fragility and relations with the US are likely to deteriorate both bilaterally and multilaterally.

Given the limits of Brazil's interest in economic integration, its stances and activities in multilateral trade fora, and in particular in the GATT, are likely to remain more important in the future. There is some scope for convergence of interests with the US in this context.

A part of the Brazilian negotiating agenda in the GATT includes issues in relation to which Brazil is a demandeur: temperate agriculture; tropical products; textile and clothing; anti dumping duties, subsidy countervailing duties and other impediments to exports of manufactures; improvement of the GATT system including dispute settlement, definition of rules and their implementation. The rest of the agenda consists of issues of a more defensive nature: "new issues" which have become traditional - services, TRIPS and TRIMS - and emerging themes which will tend to become increasingly important in multilateral negotiations. These include the harmonization of policies related to environmental protection standards, competition, and labor rights as well as to discrimination of third countries entailed by regional integration initiatives such as stringent rules of origin. There is concern that Brazil may become a preferred target of discriminatory actions by developed countries, including the US, as policy harmonization is required to assure a "level playing field".

There is a convergence of interests of Brazil and the US in relation to agricultural liberalization and most systemic issues²⁴. In relation to most other GATT "backlog" issues the two countries are likely to have more difficulty in finding common ground as Brazil is interested in improving access to the markets of developed countries, including the US. In relation to the "new issues", and, still more, to the emerging issues related to policy harmonization, the potential for friction is considerable, since the US leads the group of demandeur countries.

²⁴ The asymmetric interests concerning the new issues, particularly TRIPS, combined with certain features of the Multilateral Trade Organization proposed in the Dunkel draft, such as the integrated dispute settlement system allowing cross retaliation, could be unfavorable to countries. Similarly, the existence of several specialized councils may weaken the position of contracting parties with limited bargaining power.

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

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