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TRADE RELATIONS BETWEEN BRAZIL AND THE UNITED STATES

(Chapter I)

Preliminary Version

Prepared by the ECLA Washington Office. The opinions expressed do not necessa reflect those of ECLA.

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CHAPTER I (Draft)

Introduction

In his classic work Brazil: Land of the Future, the famous German author Stefan Zweig, writing from a European perspective at the beginning of World War II, spoke of Brazil as a continent "a world large enough to hold three, four, five hundred million people, with immeasurable wealth beneath the virgin earth." 1/ Indeed, the land mass of Brazil (3.3 million square miles) is larger than that of the continental United States, but its population of 118 million is barely one half, and its *per capita* income only one fifth of that of the United States. So impressed was Zweig by what he saw in Brazil nearly fifty years ago, that he exclaimed "I had looked into the future of our world." Today this picture is becoming a reality with gigantic strides being made which are bound to overcome the temporary setbacks that have characterized Brazilian history.

In many respects the development of Brazil shows striking similarities to those of the United States in its early growth stage. Beginning with coastal settlements along the Atlantic Ocean, both countries strove to open up the vast interior; to foster this process, both the United States and Brazil decided to move their capital cities away from the Eastern seaboard and build new cities designed specially to serve as capitals and incorporate modern urban planning techniques. Both countries have

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1/ Stefan Zweig, Brazil: Land of the Future, The Viking Press, New York, 1941.

ample resource bases which facilitated their early agricultural and mineral development, followed by industrialization. In this process, both countries relied heavily on massive immigration to provide the labour force for their burgeoning growth.

The Brazilian economy was dependent, in the past, on successive booms of commodity exports starting with sugar, which was followed by cotton and eventually coffee. The drive for industrialization may be traced to the 1930's and intensified during and following World War II when Brazil was cut off from many of its traditional suppliers of manufactured goods. During the 1960's the process of industrialization which initially had emphasized consumer goods became more complex with the expansion of steel mills and the metal-working industries which led to the creation of a domestic automobile and aircraft industry, and the production of industrial chemicals as well as pulp and paper based on local resources.

The overriding criteria for this industrialization drive was the size and potential growth of the Brazilian market itself, coupled with the need to diversify exports and embark on a systematic promotion of non-traditional exports. Without an industrial base these exports would not have been possible; simultaneously, however, new non-industrial products such as soya, poultry, orange juice, were produced for export, and to overcome the chronic shortage of fuel a sugar-based gasohol was developed.

During the decade of the 1960's, Brazil formulated a strategy to expand and diversify its exports, responding perhaps to the exhortation "Trade not Aid" which industrialized countries were advocating for the economic growth of the LDC's. As early as 1968 Brazil was exploring markets for its exports in Africa, Asia, and the Middle East, a foresight that paid off during the oil crisis, when Brazil's dependence on Middle Eastern oil imports became acute. Despite the abundant resources of minerals and agricultural products, Brazil has been severely hampered in its development by the lack of domestic petroleum resources. Thus, the oil crisis which began in 1973, has placed a heavy burden on Brazil, requiring increasing amounts of oil imports, at ever higher prices, to maintain its economic activity. In recent years, oil imports accounted for over 40% of total imports, making it imperative to expand exports at a rapid rate to pay both for imports and the rapidly growing service of the foreign debt which had been accumulated in part to cover the oil-induced deficits.

Brazilian exports were fueled by an expansionist world economy in the 1960's and the 1970's, and a domestic policy to promote industrial exports was part of the overall development plan. The heavy industrialization was accomplished with the help of massive foreign investments and loans which were attracted by the potential of the Brazilian market and the establishment of Brazilian subsidiaries in a wide spectrum of industrial products. In many cases, these companies became the pioneers of Brazilian manufactured exports, particularly within the Latin American region. At the same time, the policies and instruments to promote exports were perfected to enable a wide range of producers to participate in this process.

The 1979-80 increase in oil prices and the subsequent recession in the industrialized world provoked a slow-down of the rate at which Brazil's exports had been growing. At the same time, the recessionary effects included calls for increasing protection against imports in general, and in particular, from low-wage countries and labor-intensive industries.

Brazil suffered the consequences of these measures at a time when oil imports and prices were still high and interest payments on its foreign debt was increasing because of rising interest rates. In the U.S., committed officially to a free-trade policy, the voices of protectionism were being heard more loudly and a number of "voluntary" arrangements were worked out to limit imports in order to protect jobs and/or industries. On the other hand, U.S. wholesalers, retailers and consumers, have lately expressed their concern at excessive limitations on imports which restrict the availability of goods and maintain their prices at higher levels than needed. (The 1983 textile agreement with China vividly illustrates the conflicting interests at play, including those of the U.S. domestic textile industry on the one hand, and the consumers and U.S. wheat farmers on the other.) Furthermore, large U.S. corporations exporting sophisticated equipment and machinery also have a stake in maintaining open-trade channels.

Evidently, other industrialized countries have applied protectionist measures as well, and it will no doubt be argued that the developing countries, including Brazil, are not practicing the kind of free trade regarding their imports, which they expect from their industrialized trading partners. Yet, it must be reccgnized that they are still in the process of development and prefer to earn their way rather than depend on international handouts. This poses the question whether it is preferable for the taxpayer in industrialized countries to finance foreign aid in vast amounts to ensure economic growth, or whether those countries should be allowed to compete with their exports. These may cause certain dislocations in industrialized countries whose cost, however, would be far less than the former alternative. One may ask why these countries should be helped, one way or other. The answer is simple: apart from considerations of social equity and political stability, it would allow them to earn foreign exchange to buy the sophisticated and technologically advanced products that the U.S. and other industrial nations wish to sell in these rapidly expanding markets.

The above considerations suggest that the maintenance of high export growth rates is of fundamental importance for the industrial and economic development of Brazil and for the financing of its imports and foreign debt service.

In this connection it should be pointed out that the United States are by far the single largest merchandise exporter to Brazil (excluding petroleum) with 4.6 billion dollars in 1980 and 3.9 billion in 1981, representing 29 and 28% of total Brazilian imports (excluding petroleum).

The United States are also Brazil's largest export market, absorbing 3.5 and 4.1 billion dollars in 1980 and 1981 respectively, which accounts for 17 and 18% of total Brazilian exports. However, in terms of total US imports, Brazil ranks tenth among the principal trading partners of the U.S., and is surpassed by such other developing countries as Mexico, Taiwan, Hong Kong and Korea in supplying the U.S. market. Indeed, in relation to overall US imports in 1980 and 1981 of 240 and 261 billion dollars, respectively, imports from Brazil represented barely 1.6 and 1.8%.

In the sixties and seventies the markets of the industrialized countries were relatively open for Brazilian products. However, the long economic recession in these countries and the high growth rates of Brazilian exports have provoked increased pressure for restrictions on the imports of Brazilian products, in spite of its still low penetration rates in their markets.

Brazil has developed a modern and generally efficient production apparatus and is now internationally competitive in many industrial sectors. The industrial countries are reluctant to reduce the dimension of industries in which they have become less competitive, especially during an economic recession which makes adjustments to trade more difficult and painful. Even modern sectors are requesting restrictions on Brazilian imports or exerting pressure to open the Brazilian market, as they fear otherwise Brazil will become a strong competitor in the near future in what are today its infant-industries. Fundamental questions are thus at stake, such as the present and future international division of labour.

It should also be recalled that Brazil's industrialization process traditionally has been based to a large extent on import substitution, which is one of the explanatory factors of the existence of export desincentives that had to be overcome by the granting of subsidies.1/ This factor makes Brazil's exports specially sensitive to import restrictions, principally in the United States, where countervailing duties are applied more frequently and strictly than in other countries.2/

The increase in U.S. protectionism can also be explained by the high value of the U.S. dollar which tends to favor imports and discourage exports. Furthermore, international trade relations have become increasingly complicated. In the first place, tariffs have been reduced continuously and protection has to rely to an ever larger extent on non-tariff measures. Second, the economies of industrialized and developing countries have become increasingly interrelated. The developing countries have for a long time been the most dynamic market outlet for many sectors in the industrialized countries, principally for those of capital goods which were faced with sluggish growth in their home markets. The ability of the developing countries to pay the services of their foreign debt also depends to an increasing extent on their export performance.

1/ An important desincentive traditionally has been the overvaluation of the exchange rate.

2/ In 1982, about 25% of the value of all U.S. imports from Brazil or 40% of the value of U.S. imports of industrial products from that country were subject to either countervailing duty proceedings or to offsetting export taxes in Brazil.

The option between protectionism and free trade in the industrialized countries, is a complicated one. Exporters, importers and the banking sector will have reasons to support the maintainance of an open trading system, whereas specific economic sectors, trade unions and many politicians will support protectionist pressures. Government agencies involved in the formulation and implementations of U.S. trade policy and legislation have different discretionary authorities and also widely different standpoints.

The purpose of this study is to analize the recent development of Brazilian exports to the United States, and the relative importance of U.S. import restrictions on these trade flows. It will identify the different forms of U.S. import restriction on Brazilian products, describe briefly the way they work and quantify the value of trade involved. For the interpretation of these restrictions a short analysis will be made of the relevant elements of the trade policies of Brazil and the United States, as well as of the underlying forces of protectionist pressures in the United States. Attention shall be paid to the institutional setting of U.S. trade policy, the role of different groups in the decision making process regarding the option between free trade and protectionism and the positions of the two governments towards international trade problems, both in the framework of international organizations as in bilateral contacts. It will also briefly analyze the interrelations between different topics of international trade and between these trade topics and the foreign debt problem. The study is expected to achieve a better understanding of the commercial relations of one of the major developing countries, which has achieved high export growth rates, and its most important single trading partner, as an example of current and future relations between developing and industrialized countries.

The present study, covering United States-Brazil trade relations was undertaken jointly by the Brasilia and Washington Offices of the Economic Commission for Latin America. A similar study is underway on Brazil's trade relations with the European Economic Community.

The study consists of five Chapters: Chapter I is the present Introduction. Chapter II presents a brief description of U.S. trade policy in relation to this study and the role of different government agencies in its formulation and implementation. Chapter III comments on recent trends in Brazil's trade policy, particularly since the inception of the export promotion program, and explains its main elements as well as the external factors that contributed to changes in the orientation of Brazil's trade policy. Chapter IV presents a short review of recent trends of Brazil/U.S. trade based on official foreign trade data; U.S. market penetration of Brazilian products; Brazilian industrial and trade policies and U.S. reaction; and bilateral and multilateral discussions of these issues. Chapter V examines the obstacles to imports of Brazilian products into the U.S., in particular tariff protection and non-tariff barriers, including countervailing duties, anti-dumping duties, escape clauses and investigations under Section 301 (unfair practices). The GSP program of the U.S. and its prospects after 1985 are also examined. Chapter VI presents a summary and conclusions as well as some observations on the prospects and future evolution of trade between these two countries.