

BRAZILIAN TRADE POLICY AND THE CHALLENGE OF A NEW GENERATION OF TRADE NEGOTIATIONS

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For the past few months we are witnessing a unusual interest in Brazil on trade policy issues. The reasons are manifold. The performance of Brazilian exports has been negative and Brazil's participation in world trade stagnant at a little more than 1%. We are going through an electoral year and although trade policy issues are not at the top of the agenda the deterioration in our external account and the growing deficit in our trade in manufactured goods turns trade policy into a promising topic in the context of questioning Brazil's economic performance overall. Developments on the international front are also promoting a fresher look at trade issues. The failure of the Doha Round Brazil's preferred forum for trade negotiations has left trade negotiators without an agenda. The prospects for the EU-MERCOSUL negotiation, the only negotiation of a free trade area of any significance involving Brazil and its partners in MERCOSUL, do not look very promising. On the regional front, the integration process is stalled due to the inability of MERCOSUL to put its house in order. The Pacific Alliance changes the focus from the Atlantic to the Pacific and is an answer to the displacement of the centre of globalization to the Pacific East coast. The launching of two new major negotiations in the Pacific and in the Atlantic areas, the TPP and the TTIP, pose major risks for Brazilian exports. The end of the commodities super-cycle that contributed to obscure the deterioration of Brazilian competitiveness in world markets has led to a reappraisal of our trade policy as an instrument of development. Even in shorthand this is a long list but many more factors could be added to it.

The need for reform seems to be getting ground although the diagnosis of the patient is not shared by all and the proposals for change also diverge. The important thing is that since the proclamation of the end of import substitution as the central element of Brazilian trade policy this is a good moment to take a closer look at Brazil's trade issues and to try to change course.

The following comments are of a provocative nature, raising questions more than providing answers. Due to the dimension of the paper they are direct and summary. They are presented in the hope that they can

be useful to broaden the debate and to raise new issues and perspectives. The paper will deal first with the current debate in Brazil on trade policy. The second part will deal with the current negotiating agenda focusing on the TPP and its impact on developing countries. Finally, the paper will try to give some indications of what could be termed the geopolitics of trade. In this context special attention will be given to countries that find themselves excluded from the present negotiations and/or have to reform their trade agenda or face the challenge of being placed at the sidelines. Particular attention will be given to Brazil, China and India.

TRADE POLICY REFORM IN BRAZIL

In spite of the lackluster performance of Brazil in foreign trade there is no consensus about the causes of such a performance and the need for reform. Needless to say, there is also divergence as regards the proposals for change. The debate is however open and gaining ground in the direction for change, not only in academic fora but also in the business community. The significance of this issue in the context of the discussion in this seminar is linked to the fact that Brazil's engagement in trade negotiations, in particular in terms of plurilateral agreements and FTAs, is necessary and an important element in the reform of its trade policy. On the other hand, participation in such negotiations would, to a large extent, depend on the reform of its trade policy. To give one example, Brazil's participation in global value chains is very limited and the imported component in Brazil's exported manufactured goods not very significant. The number and importance of FTAs negotiated by Brazil together with its MERCOSUR partners is very small and involves no major trading partner. The only agreement of any significance in the list is the MERCOSUR-EU agreement, the negotiation of which has been languishing for more than ten years. This indicates that the current trade policy of Brazil does not favor trade negotiations.

Two elements of the present policy lead to the strengthening of Brazil's inward looking position. First, the view that the sole priority for Brazil is to preserve its margins of preference in MERCOSUR. Under this assumption any bilateral or plurilateral negotiation is viewed as a form of deconstruction of the regional integration arrangement. The second element has to deal with remnants of the import substitution policy which are still present in many current policies, in particular in the area of industrial policy, such as in certain variations on the themes of domestic content and export performance requirements. As a consequence, one view of the current situation is that there is nothing wrong with the current policies and the problems Brazil is experiencing on the external front derive not from

mistaken or outdated policies but from the deterioration in the international situation caused by the 2008 economic crisis and its aftermath.

More than specific aspects of current policies, two elements that are shared by many other countries that face obstacles in increasing their participation in world trade seem to merit attention. One is the view that the internal market is the priority and the springboard for growth and modernization. This leads to the creation of an amalgam of interests around the defense of the internal market for local firms. This could be called an ideological content of the current policies and it reflects the fact that globalization is seen more as a threat than as an opportunity. The other side of the argument is that trade liberalization is not perceived as an instrument for growth and development. As a consequence, there is a false opposition between internal and external markets and the priority attached to the former tends to generate in many segments of the business community a defensive attitude as regards market opening negotiations.

The bias towards the internal market and the defensive attitude towards trade negotiations are strengthened by the fact that other policies contribute to reduce the competitiveness of Brazilian exports. The level and complexity of tax policies, the lack of investment in infrastructure and the tendency to maintain an overvalued currency are some examples. This is expressed in the frequently used formula that Brazilian firms are competitive behind the factory gates but that the environment outside the gates, for which the State is mostly responsible, make competition impossible. Under these circumstances it is not only fruitless to fight for larger markets abroad but to engage in trade liberalization is a self-defeating proposition.

The assumptions just summarized are now under questioning and the electoral process under way in Brazil provides a fertile ground for airing views and debating alternative strategies. Several proposals are now being discussed and they have in common two main points. First, trade policy must be reviewed together with other policies that affect Brazilian competitiveness and contribute to the cost-Brazil. Engaging in trade negotiations and market opening could have a positive contribution in the context of this reform process as a form of securing market opportunities abroad, but it should be done in a gradual way.

Second, changes that are taking place in the world reinforce the need for reform in Brazil. In the absence of reform Brazil would face a growing marginalization and exclusion from the more dynamic sectors and markets in world trade. These changes are complex but basically have to deal with

the displacement of the center of gravity of globalization to the Pacific region, with the rise of China and its growing regional and global role, with the growing importance of integrating global value chains and developing forms of specialization, with the reduced importance in this context of barriers at the border and the growing emphasis on regulation and measures to promote localization of investment, with a new generation of technological change and the dispute for leadership in the innovation process and with a renewed contest for markets and areas of influence and access to raw materials. The new generation of plurilateral agreements under negotiation reflect these trends and Brazil is not a member of any of these negotiations and is not promoting a different trade agenda or exploring alternative routes together with other countries.

THE TPP AND DEVELOPING COUNTRIES

For some time now, major countries have pursued a diversified negotiating agenda on the trade front combining engagement in multilateral trade rounds with plurilateral, regional and bilateral initiatives. With the lack of progress in the Doha Round priority has been shifting to other fora, either in the form of major comprehensive negotiations, such as the TPP, the TTIP, or through sectoral arrangements like the TISA and the ITA. Some of these initiatives, in particular the so-called mega-agreements and other initiatives generated as a response to these negotiations, like the proposal for a possible APEC free trade area, are fueled by broader concerns that have to do with a more multipolar world.

The TPP is a good case in point to examine the nature of this new generation of trade initiatives and their impact on developing countries and the multilateral trading system. The TPP negotiations have entered their fourth year. They were scheduled to end in 2013 but difficulties in closing a deal proved greater than anticipated. The visit by President Obama to the region did not solve the remaining problems. Japan joined the negotiation later, and has added to the importance of the agreement but has also proven a difficult partner with important defensive interests in agriculture and offensive objectives in the automotive industry, among others.

Participants now envisage to conclude the negotiations in 2014 after more than 20 negotiating rounds. Even that prospect is not certain due to difficult issues still open (environment, including fisheries, labor, competition and intellectual property) but also to the opposition in the US Congress to granting the Administration trade promotion authority, in spite of the draft legislation under consideration.

Notwithstanding the current difficulties and the possibility that a final agreement will elude the negotiators the importance of the TPP involving 12 countries, 38% of world GDP and 24% of world exports, and its negotiating agenda which includes issues not regulated by the WTO, demands consideration of the possible consequences of such an agreement for developing countries and for the multilateral trading system.

The TPP is a negotiation where half of the participants already have trade agreements with the US, the importance of NAFTA in terms of trade volumes is significant (around 70%) and the majority of the countries involved are developing countries, some with an open trade policy, like (Chile and Singapore) and others with more defensive concerns (Vietnam, Malaysia). Differently from other negotiations involving ASEAN countries like the Regional Comprehensive Economic Partnership (RCEP) not all members of the association are taking part in the TPP. ASEAN is therefore not the hub. In Latin America the same happens with members of the Andean Community and the Alliance of the Pacific where Peru has joined but not Colombia, also a Pacific country. These elements are interesting to consider in terms of the possibility of consolidating integration movements in Latin America and in East Asia.

The TPP was lauded as a XXI century agreement and an agreement for the next generation. Language of this sort is common in agreements where the US has a leading position. Earlier on agreements were advertised as first class agreements and the US has always used the element of the level of ambition to promote its interests. This puts pressure on other participants to come up with concessions on areas of offensive interests of the US but also provides a safety valve as regards defensive interests, like in the agricultural negotiations of the WTO, for the failure can be attributed to the lack of ambition of others.

The understanding apparently reached that all obligations will be common and special and differential treatment of developing countries limited to longer implementation periods, a long standing position of the US in the WTO, could have important implications for the future of S and D provisions in other negotiations at the multilateral or plurilateral levels. It is not that this issue does not merit a revision in the WTO where the majority of members are more interested in defending exceptions than the general rule. But limiting S and D to discussions of the timeframe for implementation would be a step backwards in the evolution of trade rules. The way forward should be to treat development issues as a central tenet of trade negotiations, like it was agreed in the DDA, mainstreaming developing into the MTS, not as an exception but as a core principle.

The agenda of the TPP negotiations reflects the mixed composition of its members and the leading role of the US. In many areas of the agenda there is an attempt at developing disciplines on issues that are not presently covered by the WTO or where the current disciplines are very limited. These would constitute the so-called XXI Century agenda: competition, investment, labor, state owned enterprises, environment, competitive devaluation. Alongside the new agenda, the component of market access and barriers at the border is important and contentious, involving issues in the area of goods like textiles, shoes and automobiles, and in services, like insurance. In agriculture, a priority for the major agricultural exporters like the US, Australia, Canada and New Zealand that wish to consolidate access to the expanding markets in Asia, the balance of offensive and defensive interests is not easy with the food security concerns of some of the Asian participants.

The element of regulation, although not so dominant as in the case of the negotiation with Europe where the aim is to create a regulatory environment between the two largest trading areas that could become the norm for the world, is also important in the agenda, both as regards traditional issues such as rules of origin and sanitary measures, and the new agenda with financial services, electronic commerce and data transmission.

On all these issues where the disciplines could go way beyond the rules of the multilateral trading system or where there is the idea of establishing a regulatory environment that would insulate the TPP as a regulatory bloc, there is a clear risk that these mega-agreements like the TPP and the TTIP could undermine the multilateral trading system and generate a competition between different regulatory environments.

THE GEOPOLITICS OF TRADE

We are going through a period of important changes in the international system. A declining unipolarity and signs of more multipolar arrangements with the growing importance of emerging and developing countries in the global economy create major challenges in terms of orchestrating such a transition and constructing a stable multipolar world. A reform and strengthening of multilateral rules and institutions is an essential element in this context. Unfortunately, it is exactly the opposite that is happening. Not only multilateralism is weakening but we also do not see an effective leadership to push proposals for its reform. The WTO and the multilateral trading system are instances of such developments.

When a weakening of multilateralism is accompanied by a proliferation of regional initiatives which could lead to conflicting

regulatory frameworks we could be entering a troublesome zone. Trade initiatives could be pursued not as instruments of growing openness and increasing globalization but as tools to exclude and contain. If this happens the road to a broad harmonization of regulatory frameworks under the aegis of the WTO could close.

In this context, we should look at the issue of the outsiders focusing on three countries: China, India and Brazil. They are major developing countries with a dominant presence in their regions and a significant economic and trade dimension. The three are members of the BRICS and Brazil and India integrate together with South Africa the IBSA. They have an important interest in the WTO and are central in any process to reach a final agreement in the Doha Round and in agreeing to an agenda for the reform of the WTO. A TPP without China and India falls a little short of a mega-agreement.

China is clearly a special case as a great part of the motivation for the TPP and for the inclusion of Japan at a later stage in the negotiations has to deal with the ascension of China and with its growing role in the Asia-Pacific region and in the world economy. As the largest exporter in the world and the main factory economy in East Asia China plays a central role in the area. No country in the region wants to be placed in the position of having to decide between the US and China. China, whose imports are now US \$2 trillion, is part of a vast web of value chains in East Asia. Even Japan would be in a difficult position if it had to dispense with the Chinese market where all the major Japanese corporations are present.

At present, China is pursuing a strategy of maintaining its options open and creating alternatives to the TPP like the proposal recently made for an APEC free trade area, which met with the opposition of the US. China is also engaging in negotiations with another non-participant Korea and keeps in the backburner the trilateral negotiation that includes Japan. China is also on an offensive to deepen its relationship with the other BRICS countries. After the major agreements with Russia, there is an important State visit to Brazil in mid-July by President Xi Jinping that could lead to strengthening the current global strategic partnership between the two countries. Relations with India are also experiencing a good moment and the new Prime Minister of India has signaled his intention to develop relations with China. One final option for China would be to join the TPP something that would be made easier if the current reform process in China moves forward.

India and Brazil, in spite of their differences and of the fact that they operate in two very distinct geographical environments, could be placed in a similar position as regards the new mega-agreements, in particular the TPP. The two countries have not embraced globalization and are relatively closed economies. Brazil in 2012 was the 7th largest economy in the world and number 25 in terms of its exports. India had the 11th position in terms of GDP and was the 21st biggest exporter. In both countries participation of exports in GDP is much lower than in other comparable countries and certainly much lower than in China. Both countries have not actively engaged in trade negotiations outside the WTO although the record of India (15 agreements) is better than the record of Brazil (5). Brazil and India seem to face a big challenge in terms of modernization and reform of their trade and industrial policies. For both countries, a possible strategy could be to combine their reform process with a new trade agenda. This could start by enhancing their consultations on trade issues, exploring alternatives to the Doha Round and new ways for the WTO. They could also engage in new initiatives that could include exploring a bilateral trade agreement and agreements with other BRICS countries. They should also promote regional links to create more possibilities in terms of participation in value chains and developing regulatory frameworks. The areas of standards, sanitary measures and trade facilitation, together with services, government procurement and investments could offer opportunities for such initiatives.

The TPP, and its counterpart in the Atlantic, the TTIP cannot be viewed exclusively as trade negotiations. They share geopolitical objectives linked to the US pivot to Asia. Under these circumstances political tensions could be transferred to the trade front under the form of a growing competition for markets, natural resources and regulatory arrangements. To avoid such an outcome it is important to reestablish our dialogue in the WTO to arrive at a possible agreement to conclude the Doha Round opening up the way for a reform of the multilateral trading system. Brazil, India and China should engage decisively in promoting this outcome.