Brazil and the Transatlantic Community in the Wake of the Global Crisis

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Introduction

As the great global crisis eases its grasp, it is a time to reconsider relations between Brazil and the North, especially the United States and the European Union. While the world economy is still reeling, it is very possible that a new and more productive period in Brazil's relations with the US and Europe is possible. This positive outcome derives from numerous factors, most especially Brazil's "peaceful rise" to a more prominent global role and the arrival of the Obama administration whose promise of a new beginning in U.S. foreign policy has been greeted with such evident enthusiasm in Latin America.

Three preliminary observations about Brazil suggest that a more productive engagement with the transatlantic community of wealthier nations is feasible and desirable, and yet also challenging as it goes against the established grain of Brazilian foreign policy.

The first observation concerns Brazil's unique role, carved out over several decades, as a bridge to the global South, an influential voice for more inclusive global economic management. Second, the global financial crisis and its aftermath lay bare some of the weaknesses in Brazil's economic strategy, including deficient levels of savings, investment, technology, and human capital. Brazil is keenly aware of the need for a more productive interaction with the North to address these weaknesses. Third, a fundamental ambivalence permeates Brazil's approach to global reform and governance. It clearly benefits from the global status quo, i.e., integration with the world market and established institutions. At the same time, Brazil is structurally anti-status quo, seeking opportunities to distance itself from Western ideals and institutions. [1]

In all, incorporating Brazil on its terms into established institutions of global governance will be challenging, but also worth the effort. The U.S. and the global North are well advised in the short-run to encourage the participation of Brazil in the various *ad hoc* global gatherings (e.g., the G-20 group) dealing with the financial crisis. For the long-run, the goal should be to integrate Brazil as a partner into reformed multilateral institutions (in finance, trade, and regulation) as a means of assuring more stable global growth on the basis of more inclusive global management.

To understand the reasoning behind this recommendation, it is well to consider three separate issues: 1) the areas of common interests in foreign economic policy between Brazil and the transatlantic community; 2) the roots of Brazil's traditional divergences with the North; and 3) the domestic dynamics in Brazil that are leading to a change in its world view. These issues are considered in turn in this paper, followed by recommendations on how to incorporate Brazil more effectively into a transatlantic partnership.

Areas of Close Cooperation

One of the main reasons why a closer relationship with Brazil is desirable is that Brazil, Europe, and the U.S. already share fundamental foreign policy goals. Dealing with the global crisis has reinforced a need for cooperation and policy coordination. This has been particularly clear in the area of stimulating global demand. For the first time in memory, Brazil has been able to engage in counter-cyclical fiscal and monetary policies at home which have managed to stabilize some components of domestic demand. The Central Bank of Brazil, for example, has delivered substantial monetary stimulus through an accelerated program of interest rate reductions which have brought overnight rates in Brazil to single digit levels for the first time in anyone's memory. Meanwhile, the government has announced a number of emergency fiscal measures which amount to about 3% of GDP.

Brazil has also been an important part of global conversations to bolster the IMF as a source of emergency financial liquidity to the most vulnerable emerging economies. Just recently, Brazil agreed to subscribe to $10 billion in IMF bonds to bolster the Fund's Special Liquidity Facility. Brazil is also participating actively in talks to streamline and update regulation of global financial institutions. As a major emerging markets recipient of capital flows from global banks, Brazil is going to be an important part of these discussions.

[1]For a fuller analysis, see: Stefan A. Schirm: "Brazil's Rise as an Emerging Power: Implications for the U.S. and Europe", paper presented for the conference "Brazil's Rise: A U.S.-European Assessment", Center for Transatlantic Relations, SAIS, Johns Hopkins University, Washington, D.C., June 1-2, 2009.

Apart from emergency measures to deal with the crisis, Brazil's trade and investment interests are highly congruent with those of the U.S. and Europe. The U.S. is still the single largest export market for Brazil. It is true that Brazil's trade with the global South, especially China and Argentina, has been growing more rapidly, but the U.S. and Europe still account for some 50% of Brazil's total trade. Brazil and the U.S. have basically closed ranks in terms of the need for liberalization of global agricultural trade and prompt completion of the stalled Doha Round. It is significant that Brazil in 2008 broke ranks with more protectionist emerging markets, such as Argentina, China, and India, in order to support a compromise proposed by Pascal Lamy that would have restarted the Doha talks.

Europe, the U.S., and Brazil are closely tied by foreign direct investment flows as well as trade. Every major U.S. and European multinational has operations of some importance in Brazil; U.S. firms have been particularly active in the expansion of Brazil's agribusiness. The huge investment push by Spanish companies in the late 1990s and early 2000s has led to truly dominant positions in key sectors, including banking and telecommunications, both complementing and balancing the large US presence.

Foreign firms will be expected to compete very aggressively for a share of Brazil's newly discovered crude oil reserves. In something of a twist, Brazil has also spawned a large number of so-called "multilatinas", domestically based corporate giants such as Vale and Gerdau who have expanded aggressively into the U.S. and Europe as well as elsewhere.[2] Brazil's stable laws on foreign direct investment stand in sharp contrast to the wave of populist nationalizations of foreign and domestic companies that is occurring in Venezuela, Ecuador, Bolivia, and Argentina.

Finally, the development of alternative energy sources and new approaches to climate change mitigation are drawing Brazil closer to the transatlantic community. Brazil is justly renowned for its pioneering research and production of biofuels; a 2007 agreement with the U.S. pledged joint efforts to develop a global market for ethanol and other biofuels. In terms of climate change, the post-Kyoto conversations can hardly proceed without cooperation with Brazil in terms of reducing emissions and monitoring and protecting the Amazon rainforest.

Divergences with the North: Brazil's South-South Orientation

Yet Brazil and the global North are not always in agreement about how the world should work or be governed. The predominant ideology in Brazil's approach to the global economy could be defined as a national development mindset, rooted in a world view that was molded by concepts such as center-periphery, industrialized and commodity producers, in other words, by a North-South cleavage tying the technological haves and have-nots through a system of unequal exchange. The traditional mindset of a

[2] For more on the expansion of Brazil's multinationals, see: Ben Ross Schneider: "Big Business in Brazil: Leveraging Natural Endowments and State Support for International Expansion", *forthcoming*.

North-South divide has led Brazil over many decades to be extremely protectionist in terms of its industrial sector, in particular. Buffered from competition by a complex set of tariffs, non-tariff barriers, and export promotion schemes, the favored sectors in industry have always included automobiles, electric and electronic devices, textiles, clothing, and footwear. While published tariffs were reduced unilaterally in the 1990s, effective protectionist remains high and the need to continue protecting industry from unfair competition in the North is close to an article of faith among both São Paulo elites and general public opinion in Brazil.[3]

The deeply held belief in Brazil that increased global engagement with the North would inevitably reduce the "space" for autonomous development, meaning mainly industrial sector development, has caused Brazil to be skeptical of free trade agreements with the North. This traditional tendency has been accentuated in the Lula government and is most evident in the downgrading of bilateral U.S.-Brazil talks and Mercosul-EU discussions. Brazil's opposition to the U.S.-inspired FTAA resulted in its eventual demise. At the global level, Brazil has been resistant to negotiate new disciplines in the WTO in such sensitive areas as investment, trade in services, and government procurement. As Schirm reminds us, the G-20 initiative in the Doha Round talks was conceived by Brazil and other nations in opposition to EU-US initiatives.[4]

Brazil has compensated for its lack of wholehearted engagement at the global level by pursuing a series of politically symbolic, but economically questionable arrangements with the global South. It has embraced participation in the BRIC group of nations which held its first summit in June 2008. Brazil has conceived and managed Mercosul despite its many internal contradictions, and is even pushing to expand membership to include Venezuela which is clearly not ready for membership. The UNASUR framework for regional integration in South America has been heavily promoted by Brazil and the regional grouping conveniently excludes Mexico and, of course, the United States. Farther afield, Brazil has signed limited trade agreements with such minor players as Cuba and Morocco and also India. Its IBSA initiative (India-Brazil-South Africa) has attracted significant international attention, though little in the way of economic benefits.

In the realm of ideology, President Lula's has been a leading voice demanding a more equal distribution of international wealth and power, reform of the IMF and the UN and other global bodies, and a stronger role for governments in regulating global market forces which Brazil distrusts. His remarks in China just prior to the BRIC summit calling for a new global currency to replace the dollar generated headlines.

[3] Pedro da Motta Veiga: "Brazil's Trade Policy: Moving Away from Old Paradigms", in Lael Brainard and Leonardo Martinez-Diaz (eds.), *Brazil as an Economic Superpower? Understanding Brazil's Changing Role in the Global Economy* (Washington, D.C.: Brookings Institution Press, 2009).
[4] Schirm, *op. cit*. Note that this is in reference to the G-20 group of emerging economies in the context of the WTO negotiations, not to be confused with the expanded group of nations which have banded together under the aegis of the G-20 to deal with the global financial crisis.

Brazil's Changing World View

So while Brazil has pressures leading toward greater integration with the transatlantic community and countervailing pressures to set itself apart from the North, forces within Brazil itself are leading to profound alterations in Brazil's view of the world. One of these factors has already been alluded to – Brazil has recognized the need for shared management of global risks in the present crisis and has been able to make positive contributions to domestic and international stability despite the serious nature of the shock Brazil has endured.

As Brazilians have long been accustomed (e.g., in the aftermath of the Asian and Russian crises of the late 1990s) to be dragged into the vortex of global crises, the fact that the damage to economic growth so far has been minor has been greeted with great relief in Brazil. It is widely recognized that one of the reasons for Brazil's relatively safe passage through the global storm is the economic stability produced by fifteen years in Brazil of a rules-based approach to economic management featuring economic practices commonly associated with the OECD. These have included a concern for fiscal management, including a low debt-to-GDP ratio, successful inflation targeting, a floating exchange rate, and, perhaps especially, a large stock of international reserves.

All of this was capped by a coveted investment-grade rating for Brazil sovereign debt by Standard and Poor's in 2008. Brazil will always be an economy with an important role for the state and a distrust of markets, but its rules-based approach to macroeconomics puts it much closer to the OECD mainstream than to the ALBA consensus.

Important changes are occurring in the external structure of the Brazilian economy leading to a fuller engagement with the world economy. Following the "golden period" of export growth in 2003-2008, external trade is now 25% of GDP, close to the level of other large economies, and almost twice the level of a decade ago in Brazil. Much, but not all, of export growth is commodity based, including both industrial raw materials and agricultural products. It has been said that if China is (or aspires to be) the world's factory, Brazil is its farm, and also one of its critical suppliers of raw materials.

In the past, Brazil has been reluctant to embrace this role of food and raw material exporter with its implicit connotation of low technology. This attitude seems to be fading as export growth is seen not only as a means of relieving Brazil's chronic foreign exchange problems, but also insulating the economy from external shocks and stimulating economic growth. The stable exchange rate has permitted a much higher level of imports of technology from abroad which have benefited consumers and industries.

New lobbies within the business community have emerged in favor of freer trade, countering to some extent the still strong influence of the São Paulo elites. Moreover, the emergence of a global agribusiness based in Brazil has raised the profile of sectors favoring greater trade liberalization and injected an offensive agenda for Brazil in global trade talks. By the same token, the important growth of very large Brazilian companies with global reach, companies such as Gerdau, Odebrecht, Vale, and Petrobras itself, are challenging the way in which Brazilians think about the role of multinational enterprise. While it is true that Brazil is not very market-friendly, it is firm-friendly, and seeks to support this global presence by its leading state companies and private sector "national champions". As these firms grow, and their lobbying power strengthens, Brazil is likely to become more concerned with global efforts to facilitate international investment flows now that it has its own multinational companies.

An Agenda for Cooperation

In short, while Brazil will continue to seek a "world without the West" and to strengthen its South-South ties, the factors promoting a greater global integration are very powerful and suggest that the predominant tendency for Brazil in the future will be cooperation with the U.S. and the E.U. For many reasons, it makes eminent sense for the transatlantic community to incorporate and accommodate Brazil within the institutions that govern the global economy, not isolate it or patronize it. A number of policy areas come immediately to mind where grater inclusion of Brazil would be helpful.[5]

- **Reform of global governance**

Brazil has been a leading voice calling for increased representation of the developing countries in global economic decision-making and norm-setting. Reform of the IMF is the starting point. The agenda includes increasing the resources of the Fund, revising conditionality requirements, and improving its governance. This old "chairs and shares" debate has gained new urgency in the context of the global financial crisis. Brazil would be very supportive of reforms to place the IMF at the center of global policy coordination, rather than leaving that to the G-8 (or the G-1, for that matter) or another ad hoc group of nations. More to the point of the global crisis, the world would benefit from an enhanced ability of the Fund to lend freely to poorer economies grappling with sharp declines in government revenues and export earnings.

- **Reform of global financial regulation**

Global financial sector reform is needed to create a well functioning network of national and regional authorities. In this area in which North-South cooperation is essential, Brazil has been in the forefront of this debate to provide truly international supervision of financial institutions with a global reach as these have proven to be channels by which financial shocks originating in the North are transmitted quickly to the South.

[5] For background on more inclusive approaches to global economic management: "South Centre Calls for Revamping the Global Financial Architecture", November 2008, www.SouthCentre.org; and Amar Bhattacharya et al, "Responding to the Financial Crisis: An Agenda for Global Action", paper prepared for "Global Financial Crisis Meeting", Columbia University, November 13, 2008.

- **A new consensus on global trade liberalization**

The most obvious area for cooperation would be for the transatlantic community to enlist Brazil's support in stemming the tide toward increased protectionism that has been spawned by the decline of global trade in 2009. Looking more to the longer term beyond combating protectionism, Brazil is well placed in global trade talks to bridge longstanding differences between North and South particularly in the areas of market access and agricultural trade. Elements of a global grand bargain are liberalized trade in agricultural products, including ethanol, in exchange for significant movement by emerging economies on industrial sector liberalization and trade-related disciplines, such as government procurement.[6] The evolution of trade strategy in Brazil itself points in exactly this direction. If so, and if Brazil signals a clearer intent to make concessions in exchange for benefits, it could have a powerful impact on the G-20 grouping of nations within the broader WTO talks.

- **A global framework on energy and climate change**

Brazil plays a potentially important in critical areas of energy and climate change where North-South collaboration is needed and presently lacking. Brazil is obviously a global leader in the use and production of biofuels, including ethanol, and is committed to further research and to the development of truly global markets for trade in greener forms of energy. The March 2007 U.S.-Brazil agreement for research and technology in the production of biofuels has produced very little; it needs to be revisited and revitalized and perhaps extended to other countries. On climate change, Brazil has an enormously important role to play as steward of the resources of the Amazon region. Perhaps because of this global responsibility and the perception that this places limits on domestic development, Brazil has struggled to develop a coherent national strategy toward climate change. Enhanced collaboration and dialogue on climate change between Brazil and the United States, which has its own reasons for ambivalence on the subject, could improve the likelihood of success at the coming December 2009 Copenhagen meetings leading to a post-Kyoto global compact.

- **Development beyond trade: new sources of financing for emerging economies**

The global crisis has pointed to the need for long-term financing for low-income emerging economies when private financing via bank lending or bond markets dries up. This involves creating a much more important role for multilateral and regional development banks, an issue that Brazil has favored. Part of the task involves tapping into resources in the emerging markets themselves, including China and the Gulf states. Regional arrangements can also be important, including swap arrangements with Central Banks, the pooling of reserve funds, support for regional bond markets, and increased

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[6] Brazil's applied tariffs are relatively low by historical comparison, but it aggressively implements anti-dumping rules (often to protect domestic monopolies or oligopolies) and practices extremely high effective rates of protection. Clearly, the elites in Brazil who dominate industry and the foreign ministry are aware that they may be losers under broad trade liberalization. Is this really true, and, if so, how can these groups be compensated as part of the global bargain on increasing trade?

capital for the multilateral banks. The point is that a more balanced flow of investment financing, one which assures a more reliable source of credit to the emerging economies than private markets are capable of providing, could produce a more stable world economy in the future by directing more surplus savings to economies (such as Brazil) where the rates or return on investment are the highest. Besides being an advocate for less developed emerging economies, Brazil itself could obviously benefit from a strengthened network of multilateral and regional lenders as it seeks to overcome chronically low levels of public investment, including poor economic and social infrastructure.

Conclusions

Brazil's peaceful rise in global affairs makes it an extremely attractive partner in global initiatives for the US and the EU. While often wishing to project an image of anti-status quo, the thesis here is that Brazil actually would welcome a more meaningful role in managing and reforming the institutions and practices of global governance. Brazil's long-held aspirations for regional and global leadership are finally coming into better balance with its capabilities and its self-confidence is improving. For many reasons, including the shock of the global crisis, Brazil is ready for a more concrete and mature interaction with both the US and the EU. In equal measure, the global shock underlines why reform in the system of global governance to include more voice for the emerging economies is vitally necessary and why Brazil is a particularly valuable partner in this effort for the transatlantic community. The global North has become accustomed to treating with indifference or lip service Brazil's aspiration for greater inclusion in global governance and a more equal partnership with the transatlantic community. The great crisis of global capitalism 2008-09 has revealed how outmoded this non-policy truly is.