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Brazil-US Trade Relations: A Rocky Road Ahead [redacted]

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Summary

The recent negotiations over Brazil's policies on computer technologies underscore the width of the gap between the US and Brazil over fundamental approaches to trade. We believe Brazil's willingness to make some concessions on informatics reflects a studied determination to make only the minimal accommodation needed to avoid retaliation, rather than any intention to compromise on trade issues in general. In our view, Brazil, guided by an extremely aggressive, highly self-serving trade philosophy, will prove just as formidable on other looming issues, such as pharmaceutical patent protection. Moreover, Brazil's continuing political disarray has played into the hands of those in the bureaucracy and on the political left whose views on trade are the most rigid and nationalistic. [redacted]

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The Brazilian Approach to Trade

US-Brazilian tensions over trade are, in part, rooted in Brazil's view that trade is an integral part of its broadly defined economic development model, and therefore a matter

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affecting both national security and pride. Brazil has developed its export strategy--at times coupled with import substitution policies--to serve its national interests. In the 1960's it provided increased exports to help avoid depending on coffee for foreign exchange; then in the 1970's to help ease its heavy reliance on imported oil and, most recently, to help reduce the burden of burgeoning foreign interest payments. The success of this approach has inclined many Brazilians to worry that US pressure for liberalization of trade is a threat to their export-driven development model and that it is aimed at preventing the evolution of competitive domestic industries. Another longstanding preoccupation for Brazilians is their belief that multinational corporations dominate the market in many industries. As a result, Brazilian politicians often point to US pressure for trade liberalization as an attack on Brazilian sovereignty.

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Brazilians take it as an article of faith that their government should intervene heavily to bring about favorable trade conditions. Consequently, Brazil's import restrictions and its aggressive export promotion programs have frustrated many foreign commercial interests, who feel at an unfair disadvantage vis-a-vis their Brazilian competitors. Much of Brazil's effort to restrict imports is based on its perceived need to protect key infant industries. This protection ranges from requiring tedious licensing procedures, through the use of layers of entangled bureaucracy, to the outright closing of markets for industries such as data processing.

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Brazil utilizes practically all the known trade policy tools to protect its industries and promote exports. These include export subsidies and restrictions on imports that compete with potential Brazilian exports, programs for preferential export financing to trading companies, and medium term loans for exporters of Brazilian goods. The government also provides incentives for importers of capital goods and of inputs used to manufacture exported products through tax and duty exemptions. While subsidies have generally declined since 1980--due largely to the reduction and eventual elimination of two export incentive programs--they remain significant.

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Suspicious of the US

The Brazilians are leery of their commercial dependence on the US, which is their largest foreign market, and they bridle at what they regard as efforts by Washington to dictate matters of trade policy. On the one hand, they fear regulating the conduct of trade, and they continue to expect special treatment from the US. On the other hand, they resent what they believe is

protectionist sentiment in the US, believing that Washington seeks to transfer its economic concerns--such as the trade deficit--onto trading partners, particularly those with large trade surpluses or with closed markets. Some Brazilians, for example, have expressed the view that the omnibus trade bill now in Congress is specifically aimed at Brazil, as are current restrictions on items such as sugar and alcohol. [redacted]

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Brasilia may launch a campaign to prevent its phase-out from the general system of preferences program (GSP) if Washington considers it again this year, possibly claiming that the action would be discriminatory and damaging to its efforts to gain debt-servicing revenues through exports. Its GSP exports--a relatively small fraction of bilateral exports--have decreased gradually in the past three years. Brazil dropped from the third largest beneficiary of the program to the eighth by early this year. [redacted]

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Political Disarray Complicates Policymaking

Brazilian trade policy has been further complicated by the disarray that has characterized the slow-moving transition to full civilian government. President Sarney, fighting congressional efforts to trim his term, has focused on policy issues largely in terms of whether and how they will affect his domestic political strength and prospects for his tenure. Lacking decisive leadership at the top, the making of foreign trade policy has tended to fall increasingly to segments of the bureaucracy with relatively narrow interests and clear, Third-World biases. The result has been to accentuate even further Brazil's ingrained, parochial, protectionist agendas. [redacted]

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Brazil's commercial policies are directed from the Third-World oriented Foreign Ministry, which has long dominated decisionmaking on all significant international economic and trade issues. Key GATT-related positions in the Ministry are staffed by diplomats experienced in foreign trade and economic issues, who form a core of support for protectionist policies. Ministry personnel in second and third-echelon positions often make decisions independently of the foreign minister, who is largely a figurehead, according to US officials. Foreign Ministry officials generally present a united front, revealing little about any internal debates on the course of Brazilian international economic relations. Moreover, instructions from Brasilia are almost never questioned by representatives in the field. [redacted]

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In this milieu, bureaucratic groups such as the Special Secretariat for Informatics (SEI), a particularly nationalistic

body, have gained prominence. During the informatics negotiations, SEI, the principal policy body, consistently pushed a protectionist approach that subjects each new foreign investment or import proposal to a so-called "national similars" test without consistent guidelines. This practice, which gives SEI arbitrary leeway, enables it to prohibit the entry of any product it deems to have a functional equivalent--currently produced or on the drawing board--by a Brazilian firm. [REDACTED]

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The recent, well publicized differences over informatics also illustrate the relative lack of clout that key interest groups, including the business sector, have had with government economic policy. SEI was able to push its restrictive line despite calls from numerous influential businessmen and leading journals to open Brazil's closed door policy. Polls earlier this year showed that many Brazilians believed US sanctions would have been justified, given the government's stance. [REDACTED]

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President Sarney finally reined in SEI's authority--with great reluctance--after the US threatened to retaliate. He convened the National Council on Informatics--an interagency policy review group [REDACTED]

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In addition, Brasilia assured Washington that it would consider US concerns as it writes regulations to govern SEI's decisionmaking. Recent press reports indicate, however, that SEI has already proposed new rules which, if adopted, would still allow it considerable arbitrary decisionmaking authority. [REDACTED]

Trade policy has also been somewhat hostage to the intense political maneuvering over Brazil's new constitution. The current draft version contains controversial protectionist measures toward foreign investment and trade that could lead to direct confrontation with the US. For example, it curtails or prohibits foreign investment in high technology, minerals, petroleum, and health care--all industries in which there is major US participation. [REDACTED]

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These planks reflect the power of Brazil's political left, which is seeking to increase the government's ability to regulate economic and social activities. Many of the original draft provisions were written by congressional committee chairmen appointed by the center-left leadership of the majority Democratic Movement Party who are intent upon charting a constitutional course fundamentally different from the current constitution, written by the former military regime. [REDACTED]

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The protectionist proposals, as well as those granting liberal labor reforms and extending government economic powers, have sparked an outcry from Brazilian businessmen, despite the fact that many of them have long accepted a heavy state role in

the economy. As a result, a moderate-conservative bloc in the Constituent Assembly has formed to force compromise language on some draft provisions. Nevertheless, internal disunity and bickering have hampered its effectiveness and will probably permit many of the left's provisions to survive. We believe the most controversial economic and trade-related issues will probably not be resolved until implementing legislation is written late this year. [REDACTED]

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Problems to Come

These factors--Brazil's fundamental protectionist view of trade, the unsettled policymaking milieu, and the lessons learned from the informatics episode--lead us to conclude that Brasilia will remain at odds with Washington over several outstanding trade-related issues. [REDACTED]

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With regard to intellectual property rights protection, Brazil fundamentally rejects most aspects of the arguments posed by the industrialized countries, taking the position that the developing countries' right to technology transfer is really the issue. Brasilia's goal is to make any and all technology available to developing Brazilian firms at the lowest possible cost and with minimum restrictions. It can be expected to argue that efforts to protect foreign technology are an infringement on its sovereignty. Another important factor, however, is that Brazil lacks sufficient protection for patents, trademarks, or trade secrets and, while Brazilian laws include some copyright protections, they are poorly enforced. For example, customers can readily buy copies of pirated software programs or videos for little more than the price of a blank diskette or tape. [REDACTED]

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We expect that negotiations on pharmaceutical patent protection will prove difficult, as Brazil continues to resist US pressures to provide protection for ethical drug manufacturers. We expect Brasilia to be at least as insistent on this issue as on informatics, claiming that cheap healthcare products are vital to social welfare, and that patent protection would drastically raise prices. Brasilia, fearing public criticism if it allowed companies to pass on development costs through patent protection, argues that multinationals already control most of the market, making additional protection needless until the domestic industry develops. Multinational pharmaceutical firms, on the other hand, argue that the most immediate threat to their operations is the lack of profitability due to low, government-set prices, particularly on new medicines where research and development costs have not yet been recovered. [REDACTED]

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We also anticipate continuing frictions over Brazil's aggressive export promotion tactics. As Brazil's trade presence

in the world grows, and its exports further diversify, its export push will affect US interests more frequently and on more products. For example, US exporters increasingly claim that Brasilia subsidizes products in competition with US goods for third country markets such as poultry and soybeans. The Brazilians, in turn, are challenging US agricultural subsidies--such as the export enhancement program--in GATT. [REDACTED]

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Brazilian-US differences are also spilling into international arenas. Brasilia is uses forums such as the GATT's Uruguay Round and UNCTAD to rally support for trade preferences for developing countries. As a self-proclaimed leader among developing countries and with no initiatives of its own, Brazil is playing an obstructionist role in the GATT Uruguay Round actively opposing key US objectives on services, investment, and intellectual property rights. In addition to Brasilia's inexperience and lack of infrastructure to enforce even existing intellectual property rights protection, strong domestic opposition from highly protected industries fuels Brasilia's desire to avoid the extension of GATT rules to cover trade in services. As the Round's substantive talks intensify this year, Brazil is trying to disrupt the negotiations through delay tactics and procedural wrangling. [REDACTED]

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Implications

We believe that lingering tensions between the US and Brazil over a range of issues, exacerbated by Brazilian perceptions that the US can exert too much economic leverage, may, over time, prompt Brazil to seek to shift its purchases away from the US. Were Brasilia to do so, it could eventually have a significant impact on several US industries --such as coal and aerospace--despite Brazil's relatively small role as a foreign market. Brasilia--which has threatened to shift import sources during previous trade rows--has already demonstrated its ability to seek out alternate suppliers for major US imports over several years. For example, through increased self-sufficiency and imports from Argentina, Brazil has gradually lowered its purchases of US wheat--from 2.5 million MT in 1982 to possibly none this year. On coal, although industry analysts claim it would be difficult for Brazil to find substitutes for high-quality, competitively priced US coal this year, they note that other countries' marketing efforts could squeeze out US sales over time. Moreover, Brazil's considerable imports of large commercial aircraft from the US could eventually be replaced by comparable West European models. [REDACTED]

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Finally, there is little prospect that the confused political situation will be resolved any time soon. In fact, Brasilia could become increasingly unable to focus effectively on

trade issues if Sarney's term is shortened and a new presidential election campaign gets underway in earnest. In any case, even after political turmoil subsides, we expect Brazil to remain committed to a trade policy rooted in the highly aggressive, export-oriented philosophy that has prevailed to date.

Appendix: The Special Secretariat for Informatics

Brazil's restrictions on the importation of computer technology began under the military government in the late 1970s as a way to protect its "infant" data processing industry from foreign competition. Originally envisioned as a way to protect indigenous micro- and mini-computer production, the informatics restrictions expanded to include a wide variety of computer-related products. In April 1979 a special committee-- composed of officials of the National Intelligence Service, Foreign Ministry, Finance Ministry, and joint chiefs of staff-- was formed to study how to regulate informatics. The Special Secretariat for Informatics (SEI) was in turn created the following October. Placed under the control of the National Security Council (CSN), SEI was a small regulatory organization manned principally by military officers and civilian technocrats who felt that the national interest dictated limiting foreign influence in the computer industry. In 1984 the Informatics Law, which imposed broad and severe limits on technology imports and on foreign investment in high technology industries, codified the market reserve policy. [redacted]

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The advent of civilian government in 1985 brought attempts to increase civilian control over SEI but not to re-orient policy. In September 1985, President Jose Sarney removed SEI from the purview of the CSN and placed it under the control of the newly created Ministry of Science and Technology. Sarney also created the National Council on Computer Policy and Automation (CONIN), a general advisory board composed of members of Congress, industry representatives, and ministers to oversee SEI activities and policies. [redacted]

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The influence of the military and of strongly nationalistic civilians on informatics policy making remains strong. The current head of SEI, for example, is Jose Ezil Veiga da Rocha, a retired Navy captain and a staunch advocate of the market reserve policy. A prominent player in informatics policymaking since the 1970s, Ezil was a leading drafter of the Informatics Law according to the US Embassy. Another key figure is Ministry of Science and Technology Secretary General Luciano Coutinho, who as part of his duties, oversees SEI. According to various sources, he is uncompromising in his nationalism and has close ties to leftist congressmen, including prominent members of the majority Brazilian Democratic Movement Party, who support the tough informatics policy. [redacted]

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