ISSUES IN INTERNATIONAL POLITICAL ECONOMY

June 2002, NUMBER 30

The Brazil-U.S. Relationship: A Tale of Mutual Ignorance

Sidney Weintraub

One variant of Murphy's Law is that when matters get dicey in one aspect of a country's affairs, they get tense across the board. This is happening this year in Brazil. The long-running troubles in Argentina became critical early in the year and the repercussions inevitably spill over the border into Brazil, both politically and economically. Luiz Inácio "Lula" da Silva of the Workers Party (PT) ran up a commanding lead in the polls for the presidential election scheduled for October and the concern this generated in world money markets led to an increase earlier this month in the spread of Brazil's sovereign bonds (the so-called sovereign risk) to more than 1,100 basis points over U.S. Treasuries; the Brazilian real continued to slide against the dollar; and the difficulty in selling Brazilian treasury bills forced the central bank to issue short-duration bills, exacerbating the country's already unsatisfactory debt-maturity profile. Moody's Investors' Service changed its outlook on Brazil's foreign and domestic debt from positive to stable, noting that conditions for its debt rollover needs might not be favorable when these transactions have to take place.

Despite these problems, the Brazilian situation is by no means bleak, certainly not in comparison with other large Latin American countries-namely, Argentina, Colombia, and Venezuela. Brazil is likely to have positive GDP growth this year, but not much (perhaps as high as 2 percent, and therefore very little growth on a per capita basis). The country is meeting its fiscal target of a primary surplus of 3.5 percent of GDP. (The primary surplus omits interest payments and is targeted in order to prevent further debt buildup.) About 80 percent of Brazil's public sector debt is internal, and this stands in sharp contrast to the unmanageable public debt in Argentina, which is largely in U.S. dollars. Inflation in Brazil is still too high, but not inordinately so at about 7 to 8 percent on an annual basis in recent months compared with an annual goal of 6 percent. Foreign direct investment (FDI) into Brazil in 2002 is not keeping up with the torrid pace of recent years (about $25 billion a year), but should still be between $15 and $18 billion this year, making it second only to China among developing countries.

The FDI data highlight an anomalous situation, at least in terms of Brazil-U.S. relations. The United States is the leading country for foreign investment in Brazil, accounting for some 25 percent of the total. The U.S. private sector discovered the promise of Brazil many years ago and is making a big bet on the country's successful future. Much of the investment in the past was designed to exploit the domestic market, but increasingly it is intended as well to use Brazil as an export platform. The U.S. government and the U.S. Congress, by contrast, have been much slower to grasp the critical political-economic role of Brazil in South America. They took 18 months to replace the last ambassador, a reality that can best be described as scandalous. U.S. officials have been sniping regularly at Brazil during the last few years as holding back progress on establishing the Free Trade Area of the Americas, whereas in reality the United States has done more to slow progress in this hemispheric endeavor, particularly by the failure of Congress to grant fast-track trade-negotiation authority to two successive presidents.

Brazilian officials are quick to point out that U.S. import restrictions against Brazilian exports are significant, targeting in particular agricultural products. Then, on top of this existing grievance, the U.S. Congress recently passed a farm bill that sharply increases U.S. income support to growers, thereby threatening Brazilian exports, especially soybeans, not only in the U.S. market but also in third markets. President George W. Bush signed this bill, so the blame cannot be placed solely on the Congress. The conclusion of most Brazilians, as I discovered on

a recent trip, is that the U.S. government does not care- and that it does not even want to hear what the Brazilian authorities are saying.

However deserved the criticism is about U.S. negligence, most Brazilian problems-political and economic-are created in Brazil. Brazil is not a major trading nation. Its exports are only about 10 percent of GDP. To put this figure in perspective, Mexico's exports are about 35 percent of GDP. Brazil's current account deficit in recent years has been averaging around 4.5 percent of GDP, which is clearly on the high side. This, plus debt amortizations, translate into a need for external financing this year of more than $50 billion. This large amount helps explains the recent downgrading by Moody's of Brazil's debt outlook. If Brazil is not able deal with its balance-of-payments problem by increasing its export earnings, the country will remain vulnerable to any shock that reduces the inflow of foreign capital.

Concern about a Lula victory in the presidential election is part of the vulnerability that Brazil faces in its external sector. Lula has changed his rhetoric this time from what it was in his previous three presidential campaigns. He does not advocate debt restructuring. He is not adamantly adverse to trade negotiations. When he reverts to past populism, his statements are quickly reinterpreted. Many money market observers of Brazil have elephantine memories, however, and they remember Lula's past pronouncements. In addition, there is no evidence that his closest advisors have changed their outlooks. Hence, the nervousness. Lula has high polling numbers, especially in comparison with José Serra, the candidate of the current government coalition (more than 40 percent for Lula and around 20 percent for Serra as this is written), but the undecided numbers are high. Lula has been at this level before at this stage of previous campaigns and still lost. Yet, this may be the time when the high early numbers stick. The campaign will not get going in earnest until the World Cup in soccer is completed.

The Brazilian scene should be put in context by understanding Brazil's role in Latin America and the country's salience in terms of U.S. policy toward the hemisphere. Brazil is the dominant country in South America in population (172 million of South America's 350 million) and economic size. It is also the one country in South America with a sophisticated industrial structure in a number of important sectors. When the United States took action to restrict steel imports, Brazil was the country most affected in South America. Brazil, in other words, is a country that must be reckoned with if the United States is to have a meaningful hemispheric policy.

Trade-or the trade-investment combination- is the critical issue in Brazil-U.S. relations, just as it is in U.S. policy toward Latin America as a whole. This reality is what makes the U.S. farm bill- which, if it remains in place, will have a severe adverse effect on Brazil's exports and, hence, on the country's pace of economic growth-such a devastating action. In my recent visit, the common refrain was that it is naïve to listen to the words of U.S. leaders on "free" trade; it is much more important to look at what the United States does (impose import restrictions to satisfy domestic political constituencies) or does not do (in the case of the Congress, provide meaningful trade negotiation authority).

Consummation of the FTAA is in some doubt because of the combination of uncertain or potentially restrictive fast-track action and growing U.S. protectionism. And just as it will be difficult to have a positive relationship with Brazil in the absence of mutually beneficial trade policy, so will it be impossible to have a productive relationship with Latin American as a whole without an open U.S. market. Failing that, none of the other U.S. initiatives-promoting democracy, combating corruption, and seeking cooperation on anti-terrorism-hold much promise. The primary objective of Latin American countries is the achievement of high growth rates and this, given their export orientation, requires an open U.S. market.

It has become clear during the past several years that neither the United States nor Brazil knows the other country very well-what their deep aspirations are, how their domestic politics work, how they make decisions-and this is a serious deficiency. Brazilians undoubtedly know more about the United States than the reverse. We have learned repeatedly in recent years that the price of ignorance can be high- Afghanistan is the most recent example, but by no means the only one. It is unconscionable that this ignorance should exist in the United States about the most important country in South America-a region that we consider to be in our neighborhood.