

Brazil, trade multilateralism and the WTO: a medium term perspective

Executive Summary | July 2012

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Task Force

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Presentation

The constitution of the Task Force *O Brasil, o multilateralismo comercial e a OMC: uma perspectiva de médio prazo* [Brazil, trade multilateralism and the WTO: a medium term perspective] was aimed at gathering varied views of Brazilian specialists on trade and trade policy in order to propose a Brazilian agenda for the multilateral trade system.

Carried out in a period in which multilateralism – not only in trade – is going through a deep crisis, and the Doha Round has reached a prolonged impasse difficult to overcome, the exercise aimed to identify the characteristics and the agenda of trade multilateralism matching the interests of Brazil, considering a medium term perspective (10 years).

Despite having a 10-year horizon as reference, the Task Force members recognise the importance that the Doha Round come to a conclusion that, even being unambitious from the point of view of its original objectives, it builds a bridge between the troubled present and a future that is expected to be more foreseeable and promising.

The participants in this initiative were invited due to their experience and personal interest, irrespective of their institutional links.

Participants

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This Report is the result of an effort to synthesize views, not always coincident, among the members of the Task Force. However, strong convergence of views is noted in relation to the characteristics and multilateral thematic agenda of interest to Brazil. Only in the case of one issue of the group agenda (the relations between exchange rates and trade and their treatment in international forums, including the WTO) it was not possible to reach consensus on a text in the Report. The divergent views in relation to this theme are synthetically presented at the end of the Report.

1. Introduction

Trade multilateralism is going through a period of crisis, the impasses of the Doha Round being its most visible manifestation, but they are no more than a symptom. The crisis of multilateralism is rooted in deep changes in progress in the economy and in the mechanisms of governance ruling the international economic relations.

The group centred its reflections and debates on some issues that are, in our opinion, essential:

- *What factors are behind the crisis multilateralism is suffering, and what is the relative weight of external and internal factors to the negotiating process in this evolution?*
- *What factors – domestic and external – will mold the strategy of Brazil's engagement in trade, and, in the considering these factors, what should be its trade strategy and the place of multilateralism in this?*
- *What characteristics must trade multilateralism have so as to correspond to Brazil's interests and policy preferences?*

2. The international context and trade multilateralism

The conception of trade multilateralism was based on principles, such as non-discrimination and the offer of liberalization without reciprocity. This conception admitted implicitly that developing countries acted in the GATT as free riders in a world in which the negotiation involved essentially the USA and Europe. The first decade of the XXI century experienced a radical change in the economic and political context in which multilateral trade operates, reducing its legitimacy and functionality. The domestic agendas acquired enormous importance *vis-à-vis* the

international ones, the costs of liberalization came to be perceived as excessive and growing, and the domestic and international pro-liberalization consensuses lost their solidity.

Stylised processes and phenomena behind the erosion of the legitimacy of multilateral trade, in the last 10 years, are: (i) the emergence of the “South”; (ii) the meteoric rise of China; (iii) the erosion of the “liberal consensus”; (iv) the frustration with the results of the Uruguay Round in the countries of the South; (v) the growth in the number of WTO members; (vi) the multiplication of preferential agreements; and (vii) the growing disconnection between the agendas of large transnational companies and national priorities and objectives.

The effects of the international economic crisis that arose in 2008 have added new sources of tensions and conflicts to an international political environment already quite critical of globalisation.

The internal mechanisms of negotiation adopted in the WTO must also be taken into account. The adoption of the rule of consensus and the principle of single undertaking in an institution with a large number of participants increase the legitimacy of the decisions adopted, but at the same time strengthen the “veto coalitions”, and block the decision-making process. Factors inherent to the functioning of the WTO and the negotiating process play a secondary, but important, role, as they create additional difficulties for the adaptation of the WTO to the political and economic conditions in which it now operates.

However there is a growing demand for multilateral governance. The current international agenda is focused on issues like the social impacts of doubling the labour supply in the world, economic and environmental effects of the intensification of pressure on the natural resource reserves, food and security. The foreign policy of the main global actors seeks to respond to these challenges with unilateral mechanisms or bilateral arrangements.

This is a systemic and global agenda, which would, much more adequately, be dealt with at the multilateral level. The WTO will, in some way and at some moment in the future, have to take into consideration in its agenda the intersections between trade and other international agendas, such as those of climate change or food security.

3. Brazil in face of trade multilateralism

Multilateralism is the negotiating forum historically prioritised by Brazil in the trade area. The country does not feel comfortable in the “world” of preferential agreements.

a) The conditioning factors of Brazil's multilateral trade agenda

The domestic factors and interests

Brazil is undergoing a productive transformation whose vectors are the industrial and agribusiness segments natural resource-intensive. In the coming decades, this transformation should profoundly alter the picture of conditioning factors by which Brazilian external economic policy is driven.

This Task Force's proposal is based on the hypothesis that the most likely scenario of productive transformation includes: (i) the increase in weight of sectors intensive in natural resources in the industrial structure; (ii) the transformation of the industry towards a less diversified, but certainly more competitive, structure; (iii) the consolidation of internationalized competitive segments in the services sector; and (iv) the growing internationalization of Brazilian companies, through outward FDI. This new scenario makes room for more offensive positions in relation to the “external” conditioning factors of Brazil's trade strategy – like regionalism and the challenges of global governance – but concerns about the preservation of “political spaces” will not disappear.

The second domestic factor to be taken into account in the setting of the Brazilian strategy refers to the political dimension of Brazil's insertion in the international order and its aspiration for international recognition. Taking into account this aspiration among the conditioning factors of the Brazilian strategy implies reaffirming the priority accorded to multilateralism as an instance of affirmation and negotiation of the Brazilian trade interests.

But it also requires from Brazil to integrate systemic concerns and issues, related to the governance and the functioning of the multilateral trade system, into its agenda of interests. Brazil will have to assume growing responsibilities in relation to the multilateral trade system – which may require the country to distance itself gradually from its traditional position as developing countries' representative.

The external factors and interests

At least three of such factor should be considered in discussing the future Brazilian trade agenda and the role of multilateralism in it:

- The accession of two large emerging economies (China and Russia) to the WTO, which produced a substantial shift in the balance of power within the multilateral trade system;
- The growth in the number of preferential trade agreements, which may generate the relative erosion of market access conditions to Brazilian exports *vis-à-vis* those of the signatories of these accords.
- The emergence of global challenges not directly associated to trade issues, but having intersections with the area of trade.

In any scenario and whatever the policy preferences that dominate the setting of the Brazilian trade agenda, multilateralism will continue to be the priority negotiating forum for Brazil. A position compatible with domestic productive transformation and with the assumption by Brazil of global responsibilities requires not only the preservation of the priority historically conferred to multilateralism, but a greater

investment on the part of Brazil in this instance, expressed by the integration of global governance concerns into the country's strategy.

The conclusion of the Doha Round gains relevance as an essential element to overcome the current paralysis and bridge the gap between the short and medium terms. It is not within the scope of this report to discuss proposals to conclude de Round, but the Task Force recognises that Brazil should be prepared to make some concessions in non-agricultural goods and be capable of making movements in issues considered by many to be part of a “minimal agenda” for the Round, such as trade facilitation and “duty free, quota free” for least developed countries.

b) Characterising trade multilateralism that interest Brazil

The main characteristics of multilateralism that fits Brazil's interests are:

- The consolidation and improvement of the existing rules; and
- The gradual incorporation of new issues into the agenda.

The capacity of the multilateral negotiations to generate results regarding the reduction of tariff barriers has been drastically reduced. At the same time, trade flows are growingly being distorted by non-tariff mechanisms. The emphasis put on rules derives to quite an extent from these findings. New efforts of tariff liberalisation should keep the backseat in the multilateral agenda, but they can be pursued in the regional and bilateral forums.

4. Brazil's multilateral trade agenda: drivers and components

This document does not intend to detail the content of the issues of a multilateral agenda suited to Brazilian interests, but aims at pointing out such issues and the specific objectives to be pursued in each of them.

Three elements must be taken into account as priorities to define not only Brazil's thematic agenda in the WTO, in a medium term perspective, but also the main objectives of the country in the negotiation of the selected issues:

- The economic and political importance that multilateralism has and will continue to have for Brazil's international strategy.
- The global transformations in progress, and, in particular, the profound changes that were introduced by the emergence of Asia. It is essential to negotiate, in the multilateral sphere, rules that mitigate the risks of unfair competition and of economic conflicts and tensions. This requires that the traditional Brazilian position of defence of "policy space" for development policies be adapted to the new scenario.
- The prospect of productive transformation opening up for the Brazilian economy, which allows for less defensive positions, making it palatable for Brazil to include, in its multilateral trade agenda, some new issues, related to global challenges.

The issues included in the proposed agenda of Brazilian priorities in the WTO are classified in accordance with their association to one of these three elements. In certain cases, the presence of the issue may have its rationale associated to more than one of these elements, in which case the issue will be included in the "block" in which such an association is clearer and/or stronger.

4.1. Issues associated to the economic and political priority attributed to multilateralism

- Rules for preferential agreements: (i) defining concrete mechanisms for monitoring and revising preferential agreements – based on the model of the WTO Trade Policy Review Mechanism – TPRM; (ii) creating disciplines for the establishment of preferential rules in issues and areas bearing the greatest potential of discrimination against third countries (ex: rules of origin, technical and sanitary standards and norms); (iii) defining criteria and parameters that limit the use, by major medium-income economies, of the Enabling Clause.
- Dispute settlement system: this mechanism has played a relevant role in the defence of Brazil's trade interests, but the country faced difficulties in imposing retaliation with enough economic and trade significance. For Brazil the central issues are related to the enforcement of the decisions adopted. Pecuniary compensation and authorisation for cross-retaliation could contribute to the enhancement of the enforcement of the mechanism. A second-best would be the combination of pecuniary compensation with authorisation to retaliate given to third countries that also feel harmed by the non-compliance.
- Plurilateral agreements in the WTO: Brazil has traditionally opposed the negotiation of plurilateral agreements in the WTO. Although the adoption of the unconditional MFN clause in plurilateral accords of the WTO is the best option for Brazil, plurilateral agreements with a conditional MFN clause may be necessary to allow the negotiations to advance, as much in traditional areas (subsidies and agriculture), as in new issues (climate and energy).

4.2. Issues associated to the global transformations and their implications for competition among companies and national policies

- Industrial subsidies: the review of the Agreement on Subsidies and Countervailing Measures (ASCM) should combine the following elements: (i) strengthening the disciplines applicable to export subsidies, especially regarding

the notion of “*de facto* contingency” to exports; (ii) the inclusion, among the prohibited subsidies, of domestic public mechanisms that may have distorting effects on trade while pursuing objectives that prevent industrial restructuring and rationalisation, by covering company losses or forgiving companies’ debts, for example; (iii) setting of parameters and criteria that allow identification as to whether State commercial banks and State-owned enterprises act as “public entities”; and (iv) the reintroduction of a broadened concept of non-actionable subsidies, including the subsidies contemplated by Article 8.

- Agricultural subsidies: the eventual resumption of the negotiations in agriculture should concentrate efforts on commitments to limit the domestic measures of support that distort trade. An enhanced classification of the green box subsidies (non-distortive) will be necessary, as there is an evident “leakage” of the support measures to this box. Brazil’s interest rests on a progressive convergence of the treatments accorded to industry and agriculture. The reduction in tariffs and the treatment of quotas continue to be very important for the Brazilian agriculture, but this document has opted to concentrate its efforts on the deepening of the rules.
- State-owned companies: The implicit subsidy which derives from the role of the State as companies’ shareholder and the security concerns raised by the influence of geopolitical considerations on the internationalisation strategies of these companies have fostered demands for stricter regulations regarding their activities. It would be desirable the setting of disciplines that promote transparency in the shareholding control of the companies and that make it explicit the subsidies that these companies receive from their governments.
- Non-tariff measures (NTMs): the proliferation of public and private norms and standards introduce, for the Brazilian exporters, new risks and threats. Brazil’s objective should be to increase the degree of transparency regarding the use of these measures, their motivations and possible impacts on trade and investments flows. The TPRM mechanism could be used to assess the adequacy of non-tariff measures. Although a multilateral agreement of harmonisation or mutual recognition of rules is difficult to advance, this does not prevent the issues from progressing in the WTO through a plurilateral

agreement, which – by the characteristics of the issues – could include an MFN clause benefiting all the members, whether signatories or not.

- Private norms and standards: this issue introduces a new challenge to the traditional limits of the WTO agenda as it constitutes a “grey zone” favorable to *de facto* discrimination against imported products. Private-driven requirements may have a significant impact on Brazil’s exports. The WTO is an organization that regulates relations between governments. But in a context in which the importance of private agents grows in the setting of norms and standards that affect trade and investment flows, the discussion should not be restricted to specific Committees, but incorporated into the WTO agenda as such.

4.3. Issues related to the productive transformation in Brazil and its implications

- Investment: the position of the Brazilian government towards intergovernmental initiatives related to foreign investment has been clearly defensive. These positions are rooted in the aim of preserving the national autonomy to formulate and implement active industrial policies, as well as in the fact of Brazil being a traditional host of foreign direct investment, and, until recently, a marginal emitter of this type of flow. But the outward FDI flows grew significantly throughout the first decade of the XXI century. This could be an appropriate moment for reconsidering the traditional Brazilian stance regarding agreements on investments protection.
- Services: This issue is brought to the Brazilian agenda of priorities due to the need to increase productivity and competitiveness in the services sector in a period of productive transformation and restructuring, such as the one industry will be undergoing in Brazil over the next few years.
- Climate and Trade: Brazil is increasingly becoming an exporter of products that are carbon-intensive and, therefore, a potential target for “climatic measures” that distort trade. The agenda of negotiations of the relations between climate and trade in the WTO should incorporate: (i) rules for imposition of border adjustment measures (BCAs); (ii) rules and parameters for permitted subsidies

to stimulate the transition to a low carbon economy; and (iii) enforcement of the disciplines applicable to the formulation and implementation of technical norms motivated by climate concerns (in conformity with the proposal for the non-tariff measures and private norms and standards) to avoid them representing non-tariff barriers.

5. Exchange rates and trade: divergent views

The concern with the impacts of misalignments of exchange rates on the conditions of competition prevailing in the international markets – and, principally, on the competition with imports in the Brazilian consumer market – has begun to determine Brazil's strategies in the WTO as of 2008. If, on the one hand, there is growing consensus about the impacts of managed exchange rates on the competitive conditions in the international markets for goods and services, on the other, there is reduced convergence regarding the most suitable forum to deal with the matter. The absence of consensus in the international debate about the theme was reproduced in the Task Force's debates. This was the only theme on the agenda in which it was not possible to reach consensus among the Task Force members.