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ESSAYS

TRADE AND INVESTMENT OPPORTUNITIES IN BRAZIL—A BRAZILIAN PERSPECTIVE

THE HONORABLE CIRO FERREIRA GOMES*

This essay addresses the economic relationship between the United States and Brazil, focusing upon the most recent developments and evolving opportunities for trade with and investment in Brazil. Examples of business opportunities in the northeast region of Brazil will be provided, and more specifically, in the state of Ceará, which I am honored to govern.

Brazil is the fifth largest country in the world and the largest on the South American continent. The total area of the country is 8.5 million square kilometers (5.3 million square miles), which represents approximately one-half of the entire continent. Brazil's population is estimated at 146 million, over fifty-one percent of South America's total population.

In many respects, Brazil's constitutional democracy resembles the system of government in the United States. Brazil is a federal republic composed of the indissoluble union of twenty-six states, the federal district, and more than 4,000 municipalities. The states are ruled by their own laws and constitutions, which follow the general principles of the federal constitution. The federal union has three autonomous and harmonious powers, the legislative (the

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national congress, composed by the House of Representatives and the Federal Senate), the executive branch, and the judiciary.

Brazil is the tenth largest economy in the world, with a gross domestic product of over \$376 billion, approximately fifty-nine percent of the entire South American continent's domestic product. Brazil's foreign trade sector is a significant part of the nation's economy. The total annual value of Brazilian exports rose to \$31.6 billion in 1991, twenty percent of which was destined for the United States; purchases from abroad totalled \$21 billion, of which \$4.8 billion came from the United States.

It should be emphasized that, despite the economic stagnation which characterized the 1980s, the Brazilian economy is still quite stable in comparison to other Latin American nations. Brazil has the largest industrial structure of the developing countries and no deficit in basic natural resources, with the possible exception of energy. Brazil's domestic market size matches that of South Korea, Taiwan, and Hong Kong combined. Its economy is in a position to operate with full employment while generating substantial trade surpluses, unlike the situation in Mexico, Chile, and Argentina, where the resumption of growth has led to growing trade deficits in their economies. Moreover, the Brazilian exports are quite diversified.

The rate of foreign investment in Brazil declined sharply during the 1980s by one third, at constant prices. However, this decline was substantially less than the decline in many other countries, such as Argentina, where it declined by one-half. It is estimated that in Argentina, the current stock of fixed capital in the economy is equivalent to only two-thirds of what it was in 1980, a situation which in no way has been repeated in Brazil.

Moreover, approximately forty percent of the capital stock in Brazilian industry is of foreign origin, thus facilitating the inflow of risk capital and the competitive integration of the economy into the world market. Finally, Brazil's external debt, as a proportion of its GDP (thirty-two percent), is the lowest among the seventeen most heavily indebted nations, and one of the lowest in Latin America.

Brazil's economic relationship with the rest of the world, and particularly with the United States, is not limited to foreign trade. Significant economic links are established through loans and direct capital flow. More than \$19.2 billion, or twenty-six percent of all

Brazilian debts owed to international private banks, was lent by U.S. bankers, including short-term credits with high exposure for American financial institutions.

With respect to investments, the amount of capital inflow to Brazil reached \$9 billion in 1991, approximately twenty-nine percent of all foreign investment in the country. This makes Brazil the biggest investment host country in South America.

The Brazilian economy is undergoing a profound process of adjustment, with the aims of achieving monetary stabilization, normalizing Brazil's relationship with the international financial community, opening the domestic industry to international competition and foreign investments, improving public sector management, and reducing the involvement of the government in the production of goods through state reform and "privatization" of state companies.

Brazil strives to become fully integrated into international commerce and to overcome the obstacles which in the past have accounted for the virtual isolation of the country from the dynamics of the world economy. However, Brazil's chances for success in this process will depend on the willingness of industrialized countries to open their markets to Brazil's exports, their cooperation in the search for creative solutions to the seemingly endless debt crisis, and their efforts to encourage financial flows from the multilateral sources to help the heavily-indebted developing countries to finance development programs.

Greater concessions to Brazil would have only a marginal impact on the American economy, but would have a significant effect on the recovery of a vigorous future trade partner. This is a particularly important consideration in view of the current global uncertainties and strains in the American economy during the 1990s: The Brazilian economy will recover its momentum of economic growth, and its post-recovery policies will be shaped in part by the timing, manner, and conditions under which this recovery is achieved.

The Brazilian government now is taking some measures to restore an economic environment conducive to the nation's recovery. An important first step is the increasing credibility of the present Brazilian policy-makers, who are attempting to implement a stabilization package with no unexpected "shocks." In doing so, it is important to satisfy the reasonable expectations of the business

community and to reduce the uncertainty in the decision-making process of both domestic and foreign economic interests.

The recent approval of the Brazilian letters of intent by the International Monetary Fund opens new opportunities not only for increased financial flows from official international sources, but also for the restoration of voluntary private loans and portfolio or equity investment from abroad. This increased funding will have a favorable effect on Brazil's balance of payments, leading to the revival of savings and the recovery of the nation's capital formation potential.

There can be no doubt that Brazil has achieved great advances in trade liberalization through the following recent measures: Import controls have been reduced, including suppression of company and sector-specific import programs, elimination of temporary import suspensions on certain products, as well as the elimination of the required minimum amortization periods for import financing. Tariff reforms have been implemented according to a progressive and automatically scheduled agenda for the period 1991-1994. The average tariff was initially reduced to thirty-two percent, and was subjected to further reduction according to the following schedule: Twenty-five percent in 1991, twenty-one percent in 1992, seventeen percent in 1993, and thirteen percent in 1994.

The list of products still subject to "prior authorization" has been substantially reduced. Restrictions are still in place for products raising environmental, nuclear, and security concerns. Some restrictions also will continue to be applied to the "informatics sector." Even in the sensitive area of informatics, however, significant measures aimed at liberalizing trade have been adopted since 1990. The Brazilian government is scheduled to eliminate the residual import restrictions in this area pursuant to Article VIII B of the General Agreement on Tariffs and Trade (GATT) no later than October 1992.

Pursuant to this reform program, the Brazilian Congress has introduced important legislative changes, including a statutory deadline of October 1992 for termination of the remaining import controls in the informatics sector.

The government has adopted measures aimed at facilitating the inflow of foreign capital and has sent a bill to Congress concerning protection of intellectual property rights. Brazil also has concluded an \$8 billion agreement with creditor banks on arrear-

ages and is prepared to negotiate the external debt stock with the Paris Club and private banks by March or April of 1992.

Finally, the Brazilian government has taken many other steps in pursuit of foreign direct investments. Such steps include careful review of regulatory rules and exemptions from the supplemental withholding income tax on profits and dividend remittances to other countries. Such measures have been welcomed by the worldwide investment community, as confirmed by the most recent figures showing increased investment inflows from abroad, especially those related to portfolio investments in the stock exchange.

Thus, it is expected that Brazil's new macro-economic package, coupled with the efforts to implement needed structural changes, will effectively bring inflation to a halt and restore public trust. The result in the medium-term should be the establishment of favorable conditions for the revival of economic growth in the context of better balanced external accounts.

As a new role evolves for the state in the national economy, the Brazilian government also is attaining success in overcoming the negative reactions of trade unions against the sale of publicly-owned companies. Three large state-owned firms already have been sold through auctions, thus allowing the cancellation of a significant amount of public sector debts owed to the private sector, and a reduction in the national treasury transfers for the "privatized" companies.

The Brazilian government also has emphasized the adoption of measures for balancing public finances. A fiscal tightening program has been carried out to fight tax evasion and to cut expenditures. Several tax reform measures have been implemented to promote fiscal equity, such as the indexing of taxes for inflation. This fiscal austerity approach is expected to result in a primary surplus for the public sector and a consequential reduction of inflationary pressures.

Today, the economic relationships between Brazil and certain developed countries, including the United States, is at the most favorable point since the early 1970s. This improved climate is largely due to the vigorous steps taken by the new Brazilian government favoring trade liberalization, progress in human rights and environmental policies, control of nuclear power, and increased protection for intellectual property rights.

Within this broader context, it is useful to focus on the signifi-

cant potential in the Brazilian northeast, especially the State of Ceará. The Brazilian northeast includes nine of the country's twenty-six states: Alagoas, Bahia, Ceará, Maranhão, Paraíba, Pernambuco, Piauí, Rio Grande Do Norte, and Sergipe. They cover approximately 1.5 million square kilometers, over eighteen percent of Brazil's total area. In spite of considerable intra-regional differences in climate and social structure, the nine states face similar economic issues. It therefore is appropriate, for purposes of analysis, to treat the northeast states as one homogenous region.

The total population of the northeast in 1991 was about 42.3 million, or twenty-nine percent of Brazil's total population. Approximately fifty percent of the northeastern population lives in urban areas, compared to the urban average of sixty-eight percent for the entire country. In 1990, the northeast's gross domestic product (GDP) was \$49.51 billion, which is almost fourteen percent of the total Brazilian GDP. The northeastern per capita income in 1990 was \$1,120 compared to \$2,160 for Brazil as a whole. Depending upon production factors determined by climatic variability, the share of agricultural production in the northeast's GDP varies between ten percent and sixteen percent, compared to the rather stable national average of eleven percent. The level of industrial activities in the northeast lags behind the national average. In 1987, manufacturing accounted for only twenty-two percent of GDP in the northeast, compared to thirty-eight percent of the national GDP.

In both population and income, the northeast region may be compared to major countries in South America. The region's population is larger than that of Columbia (31 million in 1989) and Argentina (32 million in 1989). The northeastern economy, in terms of GDP, was about twenty percent larger than the economy of Colombia and about thirty-three percent smaller than that of Argentina in 1989. However, of the thirteen South American countries, only Bolivia and Guyana have a lower per capita GDP than the northeastern region of Brazil.

The northeast accounts for a great portion of the poverty in South America, and the population must be energized and reunited with the international circuits of trade, finance and investment. The large concentration of poverty in the northeast has always had political, demographic, and economic effects. The adverse effects of poverty have been an important reason for establishing a system of fiscal transfers and tax incentive programs

favoring the region, which have made it an attractive area for private investment.

Among such incentives is the Northeast Investment Fund (*Fundo do Investimento do Nordeste*, or FINOR), which provides financial support for capital investments and exemption from or reduction of income taxes, import taxes, and industrial value-added taxes. Another is the Constitutional Fund for the Development of the Northeast (*Fundo Constitucional Para O Desenvolvimento Do Nordeste*, or FNE.) Finally, there is the special treatment given by federal agencies and institutions for the development of the region, such as provided by the National Bank for Social and Economic Development (*Banco Nacional Para Desenvolvimento Economico e Social*, or BNDES) and the Regional Bank of the Northeast (*Banco Nordeste Regional*, or BNR).

In addition to federal incentives, the states of the northeast region have the power to offer fiscal incentives of their own to reinforce the inducements for capital investments from other countries. Furthermore, the federal government has authorized the establishment of export processing zones, particularly in the northeast. This will provide another useful instrument for attracting equity capital to produce goods exclusively for export. Such investment enterprises will benefit from regional competitive advantages such as cheap and plentiful labor, an ample endowment of natural resources, geographic proximity to the most important navigation routes, and fiscal incentives such as tax exemptions and free exchange for importation.

The state of Ceará covers approximately 145.7 thousand square kilometers (comparable to the size of Florida), accounting for 9.6 percent of the region and 1.7 percent of the country. Its population of 6.3 million is distributed among 178 municipalities. The state's capital city of Fortaleza is an important regional metropolis with 1.9 million inhabitants, making it the fifth most populous city in Brazil. In 1990, Ceará's GDP was \$7.5 billion, about two percent of the total Brazilian GDP. The largest components of the state's GDP were industrial (twenty-six percent), agricultural (fourteen percent), and services (sixty percent). The state's per capita income reached \$1,160 in 1990, about fifty-four percent of the average Brazilian per capita income.

Ceará's economy has improved as a result of the state government policy of reinforcing the productive sector through the rational and appropriate usage of scarce endowments of manpower,

natural resources, and logistic support. From 1985 to 1990, the state's GDP grew at an average rate of 3.6 percent per year (in real terms), compared to a scant 1.9 percent growth for Brazil as a whole.

Ceará's economic dynamism may be explained by the performance of the industrial sector, which was invigorated by the growth of productivity of the textile, garments, food, and metal mechanical products industries. These sectors account for sixty percent of the state's industrial growth.

The pattern of foreign trade in Ceará has followed the national trend of growth. Exports from the state increased by seventeen percent in 1991, reaching \$270 million. Half of Ceará's exports went to the United States. Imports grew by thirty-four percent in the same year, totalling \$156 million. A large share of those imports came from American suppliers.

Products commonly exported from Ceará include cashew nuts, lobsters, carnaúba wax, cotton thread, untanned hides (leather), fish, shrimp, and castor-oil plant (mamona) products. In spite of the dominance of raw goods and commodities, the share of manufactured products exported from Ceará is increasing. When the export processing zone becomes operative, it is expected that Ceará's export drive will strengthen, thus enlarging the range of opportunities in business and investments for foreign entrepreneurs.

A number of opportunities for investment already are available in mining (granite, marble), electronics, textiles (thread, garments, and woven fabrics), and food processing (fruit juice, conserves). Some of the emerging opportunities for investment in Ceará include agricultural irrigation, poultry, fruit, (tropical fruits and oleaginous trees), ocean fishing (lobster, shrimp, fish), fresh water fish and shrimp breeding, natural resources exploitation (uranium, phosphate, calcareous rocks, granite, gypsum, magnetite, diatomite), textiles and garments, automobile production, and tourism.

The state's infrastructure is conducive to development, with good highway and railway systems, adequate harbor facilities, adequate power supplies, a modern communications system, an industrial district, and well-developed hotel facilities. This infrastructure also provides a good base for expanding the tourism industry. Fortaleza's harbor offers obvious advantages in comparison with harbors located in some South Asian countries: it is closer to the

largest harbors in Europe as well as to those on the East Coast of the United States. The cost of labor in Ceará compares favorably with other developing countries, with an average hourly wage of only \$0.80, much less than the wages in South Korea (\$1.59), Singapore (\$2.47), and Taiwan (\$1.71).

It is important to emphasize that the state's official government policy is to encourage private investments. This policy is manifested by a willingness to provide tangible support to prospective investors through fiscal incentives offered by the state through its Industrial Development Fund (*Fundo Para Desenvolvimento Industrial*, or FDI), credit facilities offered by the state's official bank, and state involvement in negotiations with federal authorities concerning other financial incentives.

Moreover, the state government is reforming the state's economic structure. Ceará has emerged as one of the few states in Brazil to eliminate budget deficits and recover its savings rate and investment capacity. It has become a paradigm for modernization by balancing its budget, thereby restoring the state's credit worthiness and public trust and leading to better management in the public sector. Ceará has progressed to the extent that it now can afford to independently finance the enlargement of the economic and social infrastructure.

The state has been recognized for these accomplishments by the press, both domestic and foreign, including the noted British magazine *The Economist*. Ceará was cited as a showcase for development by the World Bank, and as a "champion" in fighting infant mortality by the United Nation's UNICEF.

In conclusion, I invite the American business community to cooperate with our developmental efforts by making profitable use of Ceará's investment opportunities. American business will be welcomed in Brazil, especially in the State of Ceará, a privileged place of stable temperature and climate, beautiful beaches, arable soil, and ample mineral resources. In summary, it is a land full of opportunities to develop a very promising business future.