SPOTLIGHT

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Five Key Economic Avenues for Strengthening US-Brazil Trade and FDI

By *Abrão Neto and Daniel Godinho*

In this Spotlight, we ask: In what five key ways can the United States and Brazil work more effectively together to strengthen bilateral trade and foreign direct investment?

Great expectations surrounded the March 2019 meeting between Presidents Jair Bolsonaro and Donald Trump in Washington. Among the top agenda items: how to inject new momentum into the bilateral commercial relationship. The two leaders did not disappoint. A number of trade-and-investment-related commitments were announced, and have the potential to significantly deepen two-way commerce and capital flows. Now, the next step is implementation of pledges made in Washington. Seizing this historic yearning for greater economic integration between the United States and Brazil would pay historical dividends for two countries that share important democratic values and historical backgrounds, and have prosperous, longstanding and mutually beneficial trade and investment relations.

The launching point for a deepening of commercial ties is significant: two-way trade in goods and services amounted to more than $100 billion in 2018. Brazil is ranked among the top-ten destination markets for US goods worldwide; in Latin America, it's the United States' number-two destination. For its part, the United States is Brazil's second-largest overall trading partner, accounting for more than 50 percent of Brazilian exports in services, and is the most important endpoint for Brazilian manufactured products. Bilateral trade is highly complementary and takes place mostly between companies operating in both countries, which reflects a substantial level of reciprocal investment and creates a vast number of jobs.

The stock of mutual foreign direct investment (FDI) in both economies is noteworthy and poised for growth. In 2015, US companies held a total asset value of US$268.3 billion and created more than six hundred and fifty thousand jobs in Brazil. Meanwhile, Brazilian affiliates held US$102.2 billion in assets in the United States, and employed more than seventy-four thousand people there. Capital flows from Brazil to the United States have increased more than tenfold in the last twenty years, making the United States the most relevant destination for Brazilian companies investing abroad.

Although remarkable, the trade and investment relationship between the United States and Brazil is still underperforming. The silver lining—as shown during President Bolsonaro's state visit—is that there are numerous ways for both countries to strengthen their economic and commercial ties. On the trade front, important inroads were made with potential new opportunities for Brazil-bound US wheat exports and for US-bound Brazilian beef exports. New measures to facilitate travel will make business trips easier, and US support for Brazil's accession to the Organization for Economic Cooperation and Development (OECD) is a welcome, and important, signal of confidence in Brazil's economic modernization.

This Spotlight builds on bilateral momentum to explore five key avenues that could generate meaningful results for, and unlock the potential of, the bilateral relationship in terms of trade and investment. These are not silver bullets or miraculous panacea for the complex challenges that exist, but rather flexible, pragmatic, and feet-to-the-ground options available for further exploration.

In what five key ways can the United States and Brazil work more effectively together to strengthen bilateral trade and foreign direct investment?

1. Paving the road for an eventual free-trade agreement (FTA)

The conclusion of a comprehensive, modern, and balanced FTA between the United States and Brazil would have the potential to produce substantial economic benefits for both countries. It is by far the most ambitious topic on the bilateral trade agenda, and it would be largely well received if both parties were in a position to launch trade negotiations immediately.

But, the real world tends to be more complex and full of devilish details. In some areas, the United States and Brazil have historically taken contrasting approaches and positions, rooted in their respective domestic practices and legislations. This is the case with intellectual property. Any development in areas where the two countries diverge would be an uphill battle.

Additionally, both the United States and Brazil are already engaged in, or on the verge of initiating, several resource-consuming trade negotiations. At the time of writing this publication, Brazil is still bound to negotiate tariff agreements together with its Mercosur partners. And, in any case, far-reaching trade negotiations demand considerable time to render concrete results.


Workers load a cargo ship with soybeans in the port of Santos. *[Reuters]*

Against this background, if preparatory political and technical work is needed before launching formal negotiations, it could be useful to start talks under a more flexible format—an exploratory dialogue or a scoping exercise. This alternative could provide the opportunity for both administrations to better assess, and develop outlines for, areas of possible future agreement. It could also allow for valuable time to trim edges, fulfill domestic requirements, and begin the requisite consultations. For example, the United States would need to notify the US Congress of its intention to negotiate an agreement, and Brazil would need to propose normative changes to Mercosur if it decides to negotiate the agreement unilaterally. Another critical step would be to gather input and gain the buy-in of domestic stakeholders.

Another approach could begin with progressive negotiations, modulating bilateral talks to seek agreements in certain areas, such as goods and services, and leaving more complex or sensitive areas for a second stage. This alternative would reduce the number of issues on the table, and may offer a viable path for harvesting swifter results.

While the United States and Brazil must remain firm in the pursuit of an FTA, it would be pragmatic for both countries to combine this goal with other objectives that allow for parallel, more immediate gains—and that simultaneously pave the way for a future FTA. This building-block approach would gradually prepare the ground for more ambitious enterprises. A broad bilateral trade and investment agenda that encompasses the key areas described in this Spotlight—particularly those of promoting a friendlier business environment for bilateral trade, and of supporting increased bilateral investment—would certainly play a constructive role.

2. Promoting a friendlier business environment for bilateral trade by reducing red tape and costs

Considering the United States and Brazil rank as the two largest economies in the Western Hemisphere, it is fair to say that trade flows between them are far below their potential. For instance, in 2018, in terms of goods, Brazil accounted for 2.4 percent of total US exports, and only 1.2 percent of imports. One important step to enhance the bilateral exchange of goods and services is to build a friendlier business environment for both imports and exports, by reducing red tape, costs, and time. Measures in the areas of customs and trade facilitation, regulatory cooperation, intellectual property, existing trade barriers, and good regulatory practices, among others, offer fertile ground for consistent and relatively quick deliverables.

Efforts to facilitate trade and promote rapid, secure, and more efficient movement of goods across borders should be a top priority. In the case of the United States and Brazil, streamlining opportunities could include: a mutual recognition agreement of Authorized Economic Operators (AEO); promotion of interoperability between national single windows for exports and imports; adoption of electronic phytosanitary certificates in bilateral trade, instead of paper documents (via the ePhyto Hub of the International Plant Protection Convention); and the full implementation of the World Trade Organization (WTO) Trade Facilitation Agreement, which could curb worldwide trade costs by between 10 and 18 percent, according to the OECD.

Economy Minister Paulo Guedes addresses investors during a state visit to Washington. *[Reuters]*

The climate for bilateral trade could also be improved by furthering regulatory cooperation intended to more closely align national standards and conformity assessments—a set of processes showing that a product meets the requirements of a standard—on mutually agreed sectors, and, as a consequence, to reduce compliance costs. Partnerships between the US Patent and Trademark Office (USPTO) and the Brazilian National Institute for Industrial Property (INPI), aimed at improving the review process for patents and trademarks, would be welcome, and would foster innovation and trade. The consolidation of the Patent Prosecution Highway (PPH) pilot project into a long-lasting agreement—and its expansion to incorporate more sectors of common interest (today restricted to oil and gas and information technology) and allow more requests—would be a short-term achievement.

It would also be helpful to reduce or, whenever possible, remove tariff and non-tariff barriers in bilateral trade, with the goal of improving market access and advancing partnerships to expand commercial opportunities. Considering that those obstacles usually represent trade irritants in the bilateral agenda, their mitigation might help to build trust and create a more positive environment for further commitments in other key areas. Considering both the United States and Brazil have already expressed resolve to tackle trade restrictions in the wheat, pork, and beef sectors, they could advance to additional areas such as steel, aluminum, ethanol, sugar, and fruits.

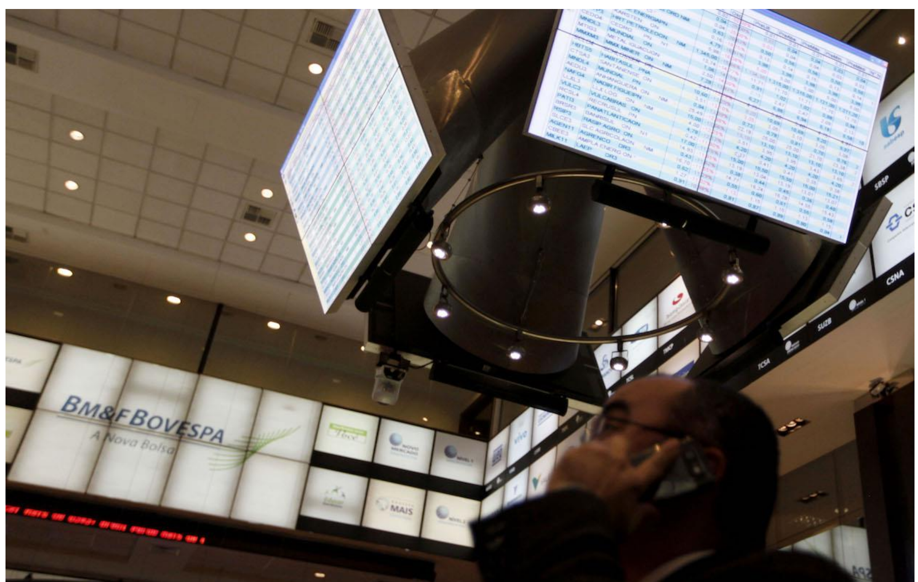
The promotion of good regulatory practices regarding trade should also be on the radar, as this supports transparency in the process of making and implementing regulations. Procedures such as public consultation, coordinated interagency review, and regulatory-impact analysis would help to improve the consistency of domestic trade rules, avoid unnecessary barriers to trade, and boost commercial exchange between the United States and Brazil.

In all cases above, both governments would gain considerably from stimulating concrete participation and contributions from the business communities that are responsible for trade on the ground.

3. Supporting and facilitating bilateral investment through joint measures to attract FDI

Trade and investment could be seen as two sides of the same coin, as they complement and reinforce each other. Therefore, fostering conditions for increased mutual FDI is a strategic area for bilateral interaction. This could be achieved through domestic policies to attract investment, and through measures to uphold legal security and economic prosperity. But, the United States and Brazil should also work toward bilateral actions to encourage reciprocal capital flows.

A double-taxation treaty would be the most important leap forward to boosting reciprocal investment. It would afford businesses in both countries important tax savings on income and interests, as well as on the remittance of dividends and royalties. Without underestimating the complexity of negotiations for a double-taxation treaty, it is reasonable to state that several issues that used to separate both countries have either been resolved (e.g., Brazil has recently signed agreements that do not provide for a tax-sparing or matching credit) or are more likely to be currently bridged (e.g., efforts from Brazil to adopt OECD recommendations on transfer pricing). A tax treaty would also greatly benefit bilateral trade in services, due to a possible reduction on tax rates, mainly on the Brazilian side.



A trader monitors display boards at São Paulo's B3 (formerly BM&FBOVESPA) stock exchange. *[Reuters]*

Another relevant action could be the signing of a bilateral investment treaty. Both countries start from different vantage points regarding investment agreements: The United States is a longtime champion for hard protection clauses and investor-state dispute-settlement (ISDS) mechanisms; Brazil has only very recently signed its first investment agreements, with an approach more focused on investment facilitation and risk mitigation.

This does not mean, however, that there is no room for convergence. Both countries could find middle ground in focusing—at least as a first step—on investment-facilitation commitments, or on mutually accepted investment-protection provisions. Consensus on establishing national one-stop focal points—to serve as a communication and support channel between investors and the host country—would help to spur more bilateral investment. This consensus could apply to the other party's investors and a joint investment committee, and to the adoption of provisions on non-discrimination, transparency, corporate social responsibility, direct expropriation, and the free transfer of funds, to mention a few examples. This could take place without each party having to compromise, at least for the time being, on issues—such as ISDS, indirect expropriation, or fair and equitable treatment—that may be sensitive for domestic constituents (in the United States' case) or are likely to face constitutional challenge (in Brazil's case).

Brazilian participation in the Global Entry program—allowing expedited clearance for preapproved, low-risk Brazilian travelers entering US territory—may be another facilitator for business and investment. It would complement Brazil's recent decision to waive visas for US visitors beginning June 17, 2019, stimulating a stronger flow of travelers, especially businesspersons.

Finally, enhanced cooperation between the Brazilian Trade and Investment Promotion Agency (Apex-Brasil) and SelectUSA to support bilateral investment opportunities could lead to increased FDI.

4. Fostering sectorial agendas in strategic and mutually beneficial areas

Another opportunity is to explore areas of collaboration—considering potential demand, complementarities, and partnerships already in place—in sectors such as infrastructure, defense, agriculture, innovation, and energy.

Headquarters of Brazilian aerospace conglomerate Embraer SA in São José dos Campos. *[Reuters]*

Building upon the work of the Defense Cooperation Dialogue created in 2016, for instance, could strengthen bilateral defense trade and investment, and increase technology cooperation between both economies. The signing of the Technology Safeguards Agreement for the use of the Alcântara space-launch base, and the US intent to designate Brazil as a major non-NATO ally, shows the potential for commercial endeavors in the area.

Infrastructure is another central area of interest for investment in Brazil. Brazil's lack of public budget availability for infrastructure spending, the desirability of greater international competition, and the necessity of improving regulations to reorganize and attract inward capital are bound to generate massive opportunities. Oil and gas, mobility (airports and ports), project management, and insurance and finance, as well as cooperation on best practices regarding public policies for infrastructure investments, are some sectors to pay attention to for possible investment opportunities.

On energy, the recent creation of the bilateral Energy Forum might serve to facilitate energy-related trade and investment.

5. Creating a high-level mechanism to oversee and strengthen the bilateral relationship

The United States and Brazil would benefit from the creation of a high-level and comprehensive mechanism to oversee and strengthen their bilateral trade and investment relations. The idea behind this suggestion is to build a strategic framework, informed by key guiding principles, for enhancing the bilateral dialogue and keeping both administrations continuously engaged.

This mechanism would serve as a high-profile forum for both governments to meet regularly and track progress on jointly defined goals. Such a body could also provide political guidance for further technical work, to be conducted by both teams.

Inspiration could be drawn from mechanisms such as the Japan-US Economic Dialogue, and the High-Level Economic Dialogue between the United States and Mexico.

Itamaraty Palace—home to the Brazilian foreign ministry—in Brasília. *[Reuters]*

The success of such a mechanism would require: the participation of government representatives at both political and technical levels, and from multiple agencies; the maintenance of a periodic schedule of meetings; a strategic working agenda; systematic monitoring of its scope; and the establishment of a formal channel for the participation of the private sector (including interaction with the reactivated CEO Forum). Ideally, this framework should be chaired by the vice presidents of both countries, and report directly and frequently to both presidents.

Such a mechanism should not replace or limit the role of the thematic bilateral dialogues already in place, such as the enhanced US-Brazil Commission on Economic and Trade Relations (under the Agreement on Trade and Economic Cooperation), the US-Brazil Commercial Dialogue, the Defense Cooperation Dialogue, the Infrastructure Development Working Group, and the Economic and Financial Dialogue, among others. Those groups should keep their autonomy and remain responsible for implementing their respective agendas. Rather, the proposed high-level mechanism should work in coordination with the existing dialogues and groups, striving to assure greater coherence and smoother interagency work among them.

Conclusion

The time seems right for the United States and Brazil to enhance their economic integration. The March meeting between President Trump and President Bolsonaro provided a critical political push, and a practical roadmap in that direction. There are additional, relevant paths that could be explored. This Spotlight touches upon five key areas that could lead to realistic—yet ambitious—results. Those are not only convergent with the issues already agreed upon between the two countries, but go a step further, offering complementary options for a stronger bilateral trade and investment relationship.

About the Authors

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