

**FIELD SURVEY REPORT: BRAZIL**

**SOUTH-SOUTH ECONOMIC COOPERATION:**  
**EXPLORING IBSA (INDIA-BRAZIL-SOUTH AFRICA)**  
**INITIATIVE**

**SOUTH-SOUTH ECONOMIC COOPERATION: EXPLORING IBSA (INDIA-BRAZIL-SOUTH AFRICA) INITIATIVE: DRAFT SURVEY FIELD REPORT, BRAZIL**

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## INTRODUCTION

One of the most significant transformations observed in the international arena in the last few years has been the higher profile countries in the Southern Hemisphere have been taking on a number of political, economic, social and environmental issues. This has translated into a stronger and more committed participation by these countries in international fora in matters as diverse as gender, trade liberalization, human rights, technological cooperation and poverty reduction. Thus, alongside involvement in political initiatives, countries in the South have become major protagonists in a number of economic fronts, including first and foremost trade policy and economic integration. Unlike the international financial regime, the international trade regime is structured so as to promote the participation of all countries since it cannot function otherwise. It takes two to trade and therefore consensus is the order of the day in trade. Institutions that seek out consensus, thus, are indispensable for the very health of the system.

The WTO is just that type of an institution. It administers a rules-based system that seeks to ensure non-discrimination and transparency in trade relations. Whether in promoting rounds of negotiations or in resolving disputes, the WTO thrives on all-inclusive agreed solutions that can provide for a sustainable regime. Developing countries had traditionally been reluctant to accept the multilateral trading system,

particularly insofar as it meant unaccountable liberalization of their markets. Nowadays things have changed considerably and these countries have grown confident that they can indeed make the system accountable for its directives and recommendations. Their increasing participation, including as significant coalitions such as the G20, is a crucial new development and has saved the day in the post-Cancun period by enticing the world's major trading partners back to the negotiating table.

Developing countries have not only increased their profile in Geneva. Since the eighties, these countries have become also major protagonists in a different, albeit related, enterprise: regionalism. Even countries that had been hardly interested in that alternative, like India, have now reviewed their priorities and acceded to the trend and, like Brazil and South Africa, have also expanded their horizons beyond their traditional "regions of influence". In other words, these countries have not only espoused regionalism as a viable element in their trade policy but also expanded the notion of regionalism to include initiatives beyond their own regions, particularly in an effort to seek understandings with other countries in the South. The IBSA initiative itself attests to that fact, as do the recently concluded Mercosul-India and Mercosul-South Africa agreements. Regional agreements such as these can be an important complement to multilateral initiatives in advancing the cause of discipline, economic reform and internationalization.

It is widely recognized, however, that regionalism can also be a significant detractor from multilateralism whenever it introduces a dangerous systemic predilection for discrimination and selectivity in the way governments trade and view trade. In short, regionalism can be good if it is supportive of multilateral discipline and bad if it is too narrowly defined. It is really up to the protagonists to decide in each case. Initiatives such as IBSA or the Mercosul-India and Mercosul-South Africa Preferential Trade Agreements, for example, can be either one thing or the other and it is up for participating countries to decide and act on their decisions in that context.

In Brazil the debate is engaged regarding the value of trade agreements, economic integration and other international arrangements as reliable means to a successful internationalization of the country's economy. There is in fact a lot of criticism being voiced with regard to the current government's ostensible preference for agreements with countries from the South as opposed to their main trade and investment partners: the U.S. and the E.U. As agreements with countries from the South have been very limited in their scope, there has been a growing suspicion that trade policy in Brazil, insofar as agreements are concerned, is no longer first and foremost a commercial matter. If it were, perhaps it should not take place, at least not as a reliable alternative to trade with the country's traditional clients. Initiatives such as IBSA or the Mercosul+1 agreements with IBSA partners, therefore, have to be something other than, or in addition to, a trade-related agreement. To many in the country, IBSA reflects the workings of a much broader geopolitical design, one that could achieve membership in the U.N. Security Council for member countries or a collective increase in influence in world affairs. IBSA therefore begs two questions: how geopolitical should trade be; or, conversely, how trade-related should geopolitics be?

This study does not purport to answer those questions directly but it certainly means to point to some clarifications in that direction. It aims to put the economic relations

among the three IBSA countries in perspective, particularly in regards to trade and investment stocks and flows. As the economic aspect of the trilateral relationship has been defined as central to the IBSA initiative, the intention here is to take an initial picture of existing market, regulatory and logistical realities that underlie that relationship to assess the effective prospects of a successful endeavor in that respect.

This study is being undertaken in Brazil by the Brazilian Institute of International Trade Negotiations (ICONE), as part of a collaborative research project entitled “South-South Trade and Investment Cooperation: Exploring the IBSA Initiative” with the Indian Centre for International Trade, Economics and Environment (CUTS-CITEE) and the South African Institute of International Affairs (SAIIA).

#### METHODOLOGY

The main result of this study are the responses of some 30 Brazilian firms - small, medium-sized export-oriented companies alongside multinational firms – to a broad-based perception mapping questionnaire during the period of March-July 2005 in various cities of Brazil. As agreed with other partner institutions, the interviews were conducted with representatives from 10 sectors:

- Chemicals;
- Metals;
- Agro-based industries;
- Automobiles;
- Leather and leather products;
- Wood, pulp of wood and paper;
- Minerals;
- Capital goods and electronics;
- Food stuffs;
- Textiles.

Not all questions were responded by all and, as the questions related often to perceptions as opposed to concrete evidence, the responses tended to be fairly diverse in their scope and content. Once the interviews were finished, the work to follow aimed to interpret the responses so as to detect and analyze overall trends in the way a cross-sectoral sample of firms perceived IBSA-related trade and investment, its prospects, and the relationship between market, regulatory and logistical realities and the official initiative at hand by the three governments involved. It should be noted that responses tend to have an intrinsic “conservative bias” as firms can be reasonably cautious in how they express their opinions regarding government initiatives. The confidentiality of their individual responses was therefore a *sine-qua-non* condition for their accepting to participate in the project – an element which, in our evaluation, made possible a considerably higher level of transparency than could have otherwise been the case.

## FINDINGS

### Trade and Investment

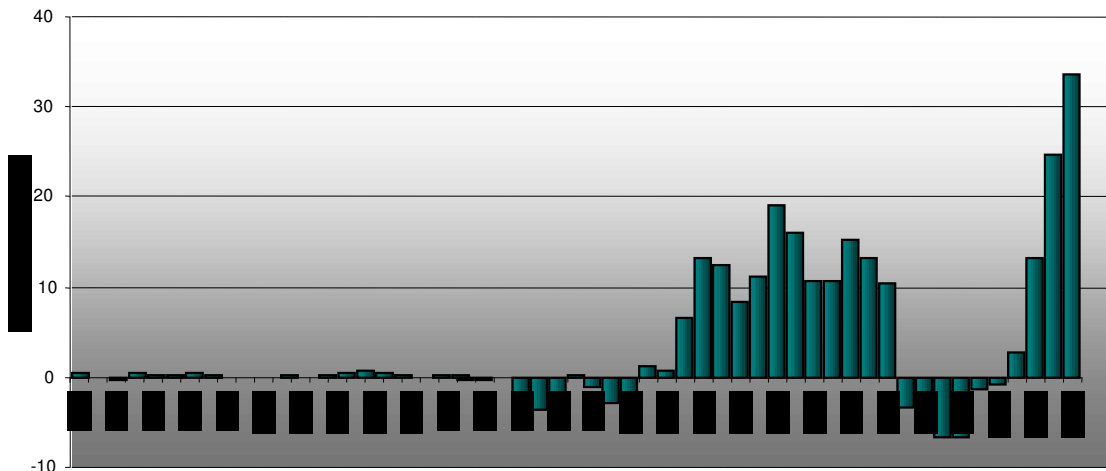
#### Current Trade Patterns: Are India and South Africa Important?

Brazil's foreign trade has been on a very bullish trend for the last few years. Surpluses have occurred repeatedly since 2001 but the consistent positive tendency cannot, however, be attributed solely to the 1999 devaluation – highly praised as one of the main reasons for export success ever since. The fact is that world markets have been especially "friendly" to Brazilian products, particularly commodities, and that China has played an important role in that context. In addition, world economic growth and consequent demand have also been important in keeping Brazil's external balances more positive than they would otherwise be.

#### *Overall Trade*

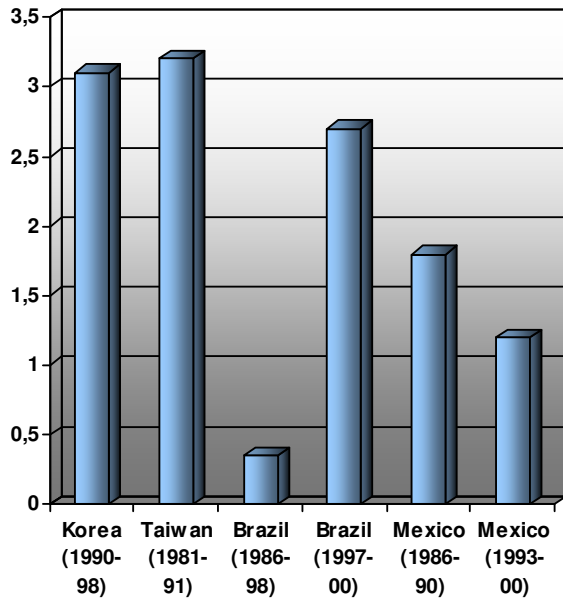
Graph 1 indicates the evolution of Brazil's trade balance since 1950. The small balances of the 50's and 60's alongside the deficits of the 70's and the surpluses of the 80's indicate the period of Brazil's import substitution policies, punctuated by the oil crises of the 70's and the need to generate export surpluses to pay the foreign debt in the 80's. The deficits of the second half of the 90's track broadly with the stabilization plan instituted in 1994 and a currency widely perceived as overvalued for the period. Things began to change, therefore, as from the beginning of the new millennium. The surpluses since 2003 have been the highest in the country's history.

**Graph 1: Trade Balance - 1950-2004**



The move from a deficit of over US\$ 8 billion in 1997 to a surplus of almost US\$ 34 billion in 2004 can also be attributed to a significant increase in productivity during the

**Graph 2: Liberalization and Productivity Gains**



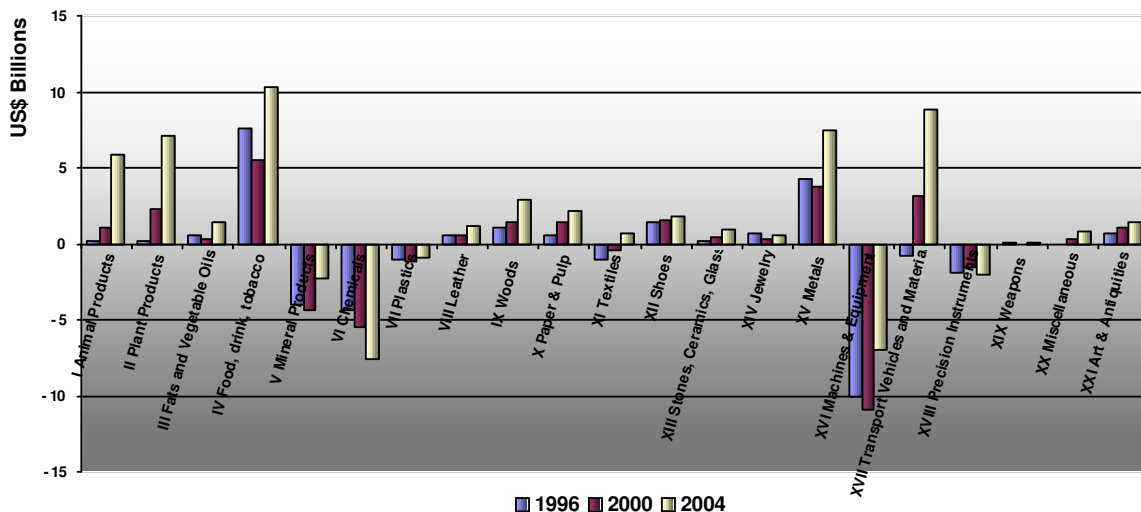
90's – particularly in the context of the modernization that the economy underwent in the period. The graph 2 below compares the increase in productivity levels across a couple of countries and for different periods, demonstrating the great leap for the post-liberalization period in Brazil, comparable to Korean and Taiwanese levels. Even though Brazil has one of the world's highest interest rates, tax burden and logistical costs, a few industrial sectors have fared extremely well, having reached increases in productivity to the tune of 115% in the decade. Those tend to be sectors in

agribusiness.

In the period between the highest deficit (1997) to the highest surplus (2004), Brazilian exports grew more than the world average. Of the main chapters in the Harmonized System (HS), only the aeronautical, shoe and mineral sectors grew less than the world average. Brazil has a share of the world market that is superior to 6% in only six HS sectors.

On the import side, the devaluation of both 1999 and 2002 had a significant restraining effect, particularly given that overall growth and domestic demand were relatively low at those junctures. As a result of both "hick-ups", private financing dried up while the government started in 2002 a monetary tightening cycle which would only end by the first semester of 2005. Another drag on growth that should be mentioned is the power shortage and subsequent rationing that took place in 2001. Imports had significant

**Graph 3: Trade Sectoral Balances, Brazil 1996, 2000, 2004**



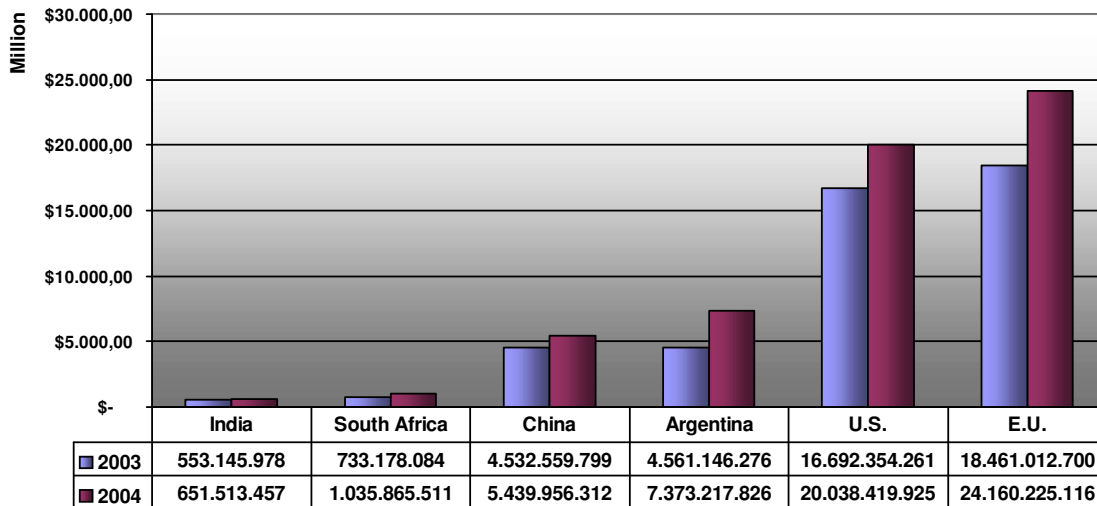
declines in the sectors of machinery, electronics, organic chemicals and autos while in plastics, optical/medical, precision instruments, cereals and pharmaceuticals there were increases but small ones. Import levels were superior to world import levels only in fertilizers – a crucial input for the agribusiness industry.

Graph 3 gives an indication of the sectoral trade balances for three crucial years in recent Brazilian economic history: 1996, when the country had the worst trade deficit in its history up until then; 2000, when the country had its smallest trade deficit during the "Stabilization Era", already geared to the turn-around that would begin to occur in the subsequent year; 2004, when the country had its highest ever trade surplus. The graph demonstrates how only a few sectors did not improve their trade positions since 1996. Also, it becomes clear that there are salient cases – both upwards and downwards. The following should be noted:

- Of the sectors with a deficit in 1996, only two - chemicals and precision instruments – had worse deficits in 2004;
- Of the sectors with a deficit in 1996, two – textiles and transport vehicles and materials (autos and auto ancillaries) – transformed their deficits into surpluses by 2004; the automotive sector stands out in this context, having produced a turn-around of over US\$ 10 billion in the period;
- The chemical sector stands out for the worsening of its deficit in the period; the machinery and equipment sector (comprising capital goods and a number of electronic consumer goods), the second highest deficit in 2004, at least appears to be reacting positively to a more competitive currency, having decreased significantly its deficit in relative terms over time;
- The mineral sector also has had an important but decreasing deficit over time, mostly due to fuel imports; without chapter 27, the sector actually has had a surplus over the period (almost US\$ 5 billion in 2004);
- The agribusiness sector is by far the most competitive, with a significant increase in surpluses over the period;
- In addition to agribusiness, transport material and equipment, leather, wood, pulp of wood and paper, and shoes, have had increasing surpluses as well.

Brazil's trade is highly diversified. Close to 50% of all trade flows are with the US and the EU. Mercosul accounts for 10%, the rest of Latin America for another 9%, Asia for 17% and Africa for a mere 7% of the total flows. Graph 4 above puts things in perspective in relation to IBSA countries as well. As it stands, the distance between the major trading partners and the second-placed ones (they have been trading places lately) – Argentina and China – to Brazil's IBSA partners is significant indeed. While Brazil's exports to Argentina were almost 3 times smaller than to the U.S., they are 11 times and 7 times bigger than the value to India and to South Africa, respectively, in 2004. If that can be taken as an indication of potential, then there is a lot of potential in IBSA trade. So far, however, there is *not much more than* potential.

**Graph 4: Brazilian Exports in US\$, 2003-2004**



*IBSA Intra-block Trade*

In order to examine the prospects for increased trade among IBSA countries, this section will probe more deeply into the trade scenario as it stands for each of the two principal bilateral relationships in question from a Brazilian perspective: Brazil-India and Brazil-South Africa. It will first look at the general trade numbers in each of the relevant trades and then resort to three basic indexes, as explained below, to give a better sectoral idea of participation, representativeness and dynamism in that context.

The *General Participation Index* (GPI) is given by the relation between overall exports of country A to country B as a part of country B's overall total imports. The same relation, when given in terms of a specific product, constitutes the *Sectoral Participation Index* (SPI) - in other words, the exports of country A *in a particular product* to country B as a part of country B's total imports *of that product*. The two relations, the GPI and SPI, are as such:

Exports [of product X] from country A to country B

-----  
Total imports of product X by country B

The *General Representativeness Index* (GRI) gives a notion of the importance of overall country A's exports to country B in relation to the total exports by country A to the world. The same relation, when given in terms of a specific product, constitutes the *Sectoral Representativeness Index* (SRI) - in other words, the exports of country A *in a particular product* to country B as a part of country A's total exports *of that product* to the world. The two relations, the GRI and the SRI, are as such:

Exports [of product X] from country A to country B

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Total exports [of product X] from country A to the world

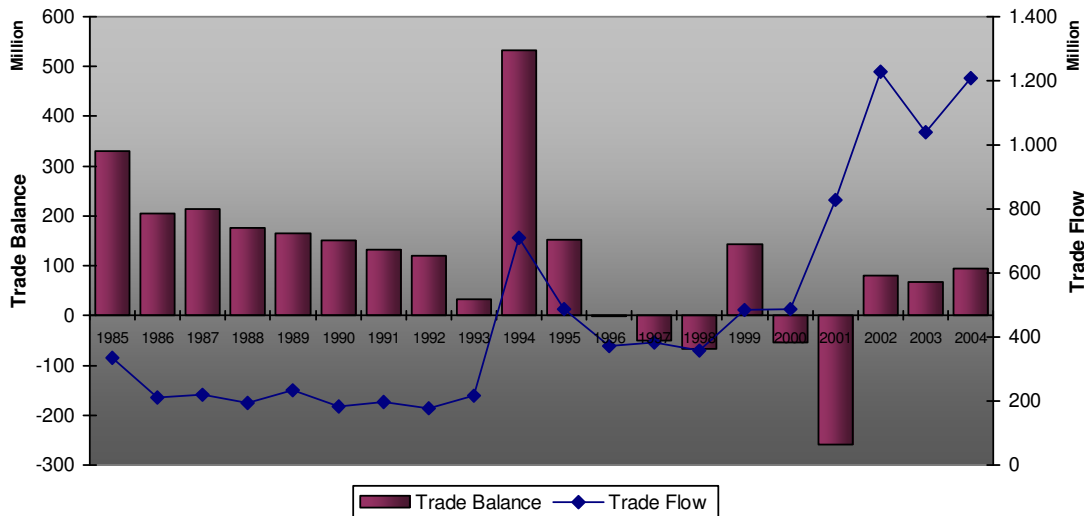
The *Dynamism Index* (DI) gives then a notion of the relevance of the growth of country A's exports of a particular product to country B during a certain period (herein, 1999-2003) in relation to the growth of total imports by country B over the same period. The relation stands as such:

$$\frac{\text{Growth of exports of product X from country A to country B during a certain period}}{\text{Growth of total imports by country B}}$$

### Brazil-India Trade

As can be seen in Graph 5 below, trade with India increased from US\$ 484 million in 1999 to a little over US\$ 1.2 billion in 2004 – an increase of close to 150% in the period and growing. The values are, of course, relatively small, accounting for only 0.76% of Brazil's overall trade flow. The bilateral trade, unlike the patterns for most bilateral trades and for the overall trade balance with the world over time, has been fairly erratic since the mid-90's with surpluses and deficits alternating from year to year – a clear reflection perhaps of the importance of particular products in particular years or of oscillating regulatory, logistical or market conditions impinging upon that trade. Thus, the bilateral trade does not point to Brazilian deficits during the pre-devaluation stabilization period (1994-1999) and Brazilian increasing surpluses ever since as in most other bilateral trades. In fact, it was in 2001 that Brazil had its worst historical deficit with India, to the tune of almost US\$ 260 million.

**Graph 5: Brazil-India, Trade Balance and Flow, 1985-2004**



Graph 6 corroborates the erratic behavior of the bilateral trade, this time depicting Brazilian exports to India by sectors. Since 1985, manufactured and semi-manufactured goods were predominant exports to India, having peaked significantly in 1994. In 2002,

however, primary products took over the lead but only for some time as semi-manufactures and manufactures came back and restored their predominance. The four main export items from Brazil to India accounted for roughly 70% of the total in the first semester of 2005: raw sugar cane, crude soya bean oil, ethyl alcohol and crude petroleum oils. These items have been the biggest growth items in Brazil's exports to India with raw sugar cane reaching more than 560% and ethyl alcohol more than 460% growth in the first semester of 2005 when compared to the same period of 2004. In the industrial area, a few organic chemicals (chapter 29) have stood out, followed by cars between 1,000 cc and 1,500 cc whose exports have grown over 126% in the same period.



In 2004, 84% of Brazil's exports to India were manufactures (40%) and semi-manufactures (44%). In relative terms, Brazil sells more primary products to India (16%) than to the U.S. (8%).

Total Indian exports to Brazil accounted for 0.54% of all Brazilian imports and 0.43% of total Indian exports. In other words, the General Participation Index (GPI) for Indian exports to Brazil is 0.54% while the General Representativeness Index (GRI) is 0.43%. The overall growth of Indian exports to Brazil was 24% during the 1999-2003 period.

The table 1 below indicates the 22 sectors, by order of US\$ values, where Indian exports to Brazil were above US\$ 1 million in 2003 (according to data from the ITC Comtrade of 2005) and the Participation and Representativeness Indexes for each. The PI and RI for the item "total" correspond respectively to the GPI and GRI (0.54 and 0.43) whereas the individual PI's and RI's to follow are the sectoral indexes.

**Table 1: INDIAN EXPORTS TO BRAZIL, PARTICIPATION AND REPRESENTATIVENESS**

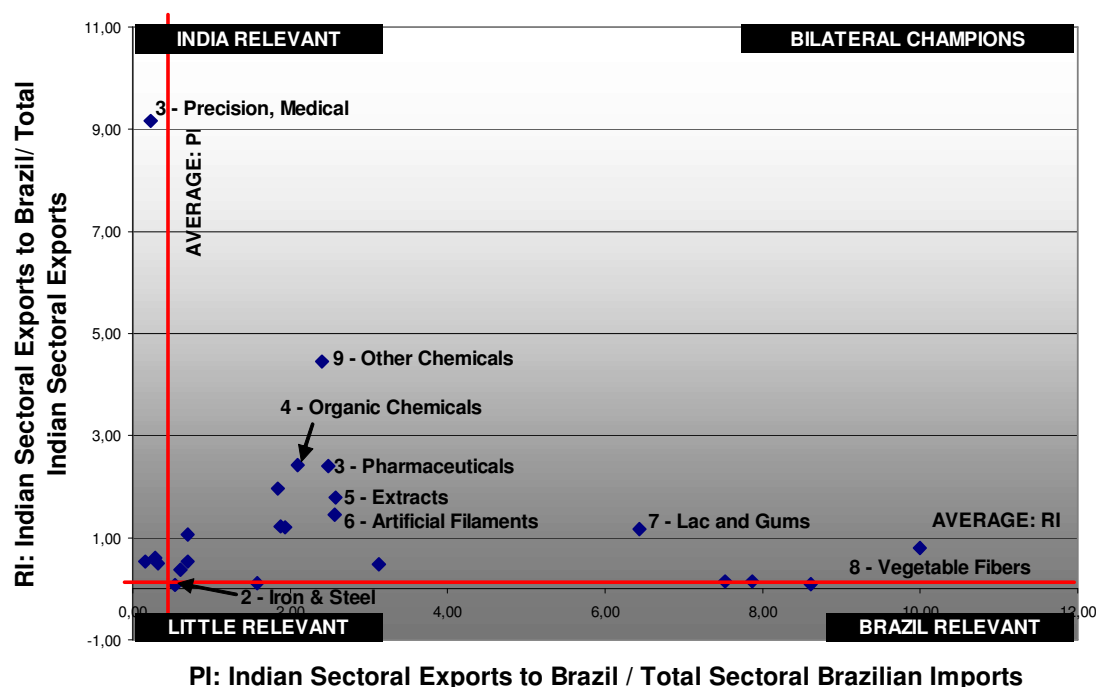
Sectors	US\$ Thousands	PI	RI
<b>Total</b>	<b>272188</b>	<b>0.54</b>	<b>0.43</b>
Organic Chemicals	67607	2.10	2.42
Pharmaceuticals	38609	2.49	2.41
Other Chemicals	25283	2.40	4.45
Fuels	22501	0.28	0.61
Machinery	13091	0.16	0.53
Artificial Filaments	12502	2.56	1.46
Extracts	11956	2.58	1.79
Vehicles	8465	0.32	0.49
Rubber	6967	0.70	1.06
Apparel, Not Knitted or Crocheted	4872	7.53	0.14
Precision, Medical, Surgical instruments	4226	0.23	9.16
Glasses	4082	1.84	1.97
Oils and Perfumery	3771	1.93	1.20
Tools	3607	1.88	1.23
Lac and gums	2799	6.43	1.17
Cotton	2509	1.59	0.10
Iron and Steel	2135	0.53	0.08
Oleaginous	1682	0.60	0.38
Clothing articles	1503	8.61	0.09
Vegetable oils	1137	0.70	0.54
Vegetable fibers	1081	9.99	0.81
Rugs and Carpets	1027	7.86	0.14

**Source:** International Trade Centre (ITC) Comtrade, 2005

Of the 22 sectors listed in the table, only 12 have both SPI's and SRI's above the corresponding general indexes (GPI and GRI). These are sectoral exports therefore that are important in terms of both Brazilian imports as well as Indian exports; or, in other words, they are exports from India to Brazil that are indeed important for both Brazil and India. That can be best visualized in the graph 7 below where the 22 sectors are plotted on four different quadrants depending on the relation between PI's and RI's.

Thus, sectors such as organic chemicals, pharmaceuticals, other chemicals, artificial filaments, extracts, rubber, glasses, perfumery, tools, gums, vegetable oils, vegetable fibers, special fabrics are considered the "bilateral champions" in Indian exports to Brazil since, as seen on the structural graph above, they sit in the quadrant for values above the general participation and representatives indexes: in other words, they are Indian exports that are important both for Brazil as an origin of imports as well as for India as a destination of exports in those sectors.

**Graph 7: Indian Exports to Brazil - Sectors Participation and Representativeness**



The tendency, however, is not for all sectors to be that way. Some are more important as Brazilian imports than as Indian exports. For example, the sector of apparel not-knitted or chocheted had a SPI of 7.53 but a SRI of 0.14 indicating that it is very important as a Brazilian import item but of little relevance as an Indian export; likewise with apparel articles that exhibit respectively the indexes of 8.61 and 0.09. Both of these items figure in the "Relevant for Brazil" quadrant in the structural graph. For these sectors Brazil has India as an important source of imports but for India, in these sectors, Brazil is not an important client relative to all its other clients in the world. The only reverse case, where the sector is more important as an Indian export than as a Brazilian import item is the precision, medical or surgical instruments sector where the SPI and the SRI are 0.23 and 9.16, respectively.

**TABLE 2: INDIAN EXPORTS TO BRAZIL, DYNAMISM 1999-2003**

Products	Value	Variation	DI
	US\$ Th.	%	
<b>All</b>	<b>272188</b>	<b>24</b>	
Glasses	4082	62	2.6
Artificial Filaments	12502	53	2.2
Precision, Medical, Surgical	4226	40	1.7
Steel articles	1422	40	1.7
Pharmaceuticals	38609	33	1.4
Rubber	6967	21	0.9

Machinery	13091	17	0.7
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Source: ITC, Comtrade, 2005

Variation refers to growth in % of exports from India to Brazil in the 1999/2003 period.

To complete the picture, a brief look at the Dynamism Index (DI) (table 2 above) reveals that the sectors of glasses, artificial filaments, precision, medical and surgical instruments, steel articles and pharmaceuticals have been dynamic as Indian exports to Brazil, having grown more than the overall average of Indian exports to Brazil in the 1999-2003 period, having thus DI's larger than 1. With this additional indicator, therefore, one can safely single out the sectors where Indian exports have a good and promising performance, accumulating positive participation, representativeness and dynamism in Brazil trades:

**TABLE 3: INDIAN EXPORTS TO BRAZIL, BEST PERFORMANCE SECTORS**

Glasses
Artificial Filaments
Pharmaceuticals

As far as Brazilian exports to India, the GPI and the GRI correspond, respectively to 0.72 and 0.76 while the growth in overall Brazilian exports to India in the period 1999-2003 was of 25%. The table 4 below indicates the 18 sectors, by order of US\$ values, where Brazilian exports to India were above US\$ 1 million in 2003 (according to data from the ITC Comtrade of 2005) and the Participation and Representativeness Indexes for each. The PI and RI for the item "total" correspond respectively to the GPI and GRI whereas the individual PI's and RI's to follow are the sectoral indexes (SPI and SRI).

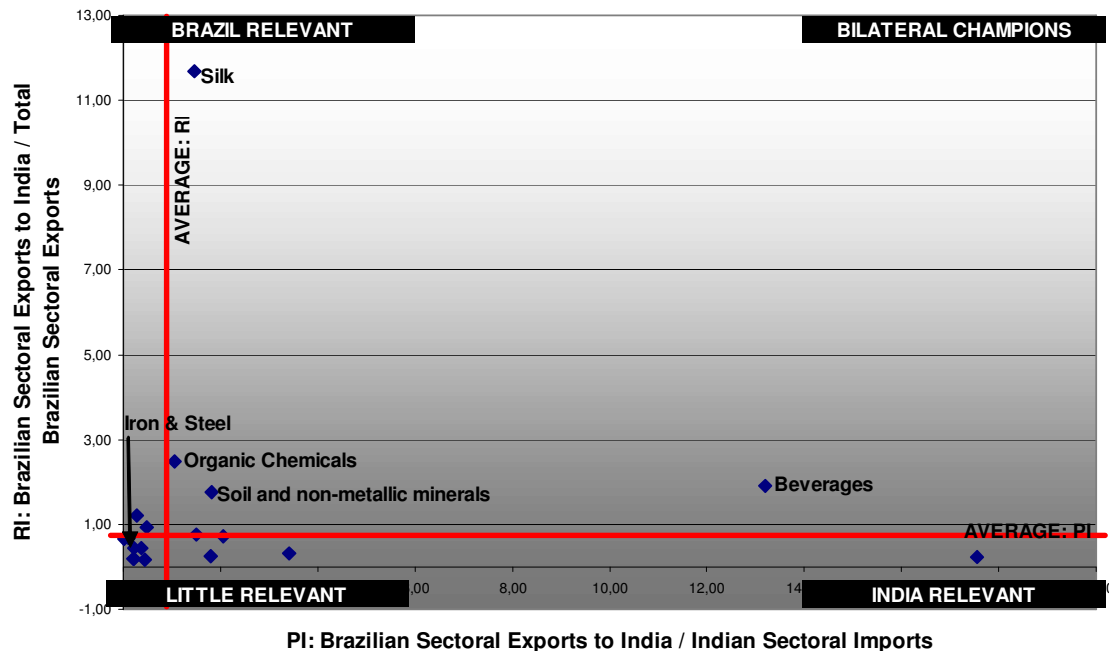
**TABLE 4: BRAZILIAN EXPORTS TO INDIA, PARTICIPATION AND REPRESENTATIVENESS**

Sectors	US\$ Thousands	PI	RI
<b>Todos</b>	<b>553.131</b>	<b>0,72</b>	<b>0,76</b>
Organic Chemicals	32.436	1,05	2,49
Fuels	25.717	0,11	0,68
Machinery	25.237	0,37	0,45
Vehicles	19.023	3,41	0,31
Electro-electronics	14.458	0,22	0,45
Vegetable Oils	12.469	0,49	0,93
Minerals	8.964	1,79	0,25
Iron & Steel	7.937	0,45	0,17
Rubber	7.263	1,50	0,76
Soil and Non-Metallic Minerals	7.221	1,82	1,77
Sugar and Confitery	5.494	17,56	0,24
Precision, Medical, Surgical	4.243	0,28	1,21
Beverages	3.909	13,20	1,91
Precious Stones and Metals	3.742	0,03	0,67
Silk	3.696	1,47	11,69

Perfumery and Oils	2.014	2,06	0,73
Iron and Steel Articles	1.419	0,22	0,20
Cotton	1.017	0,21	0,19

Of the 18 sectors listed in the table, only 5 have both SPI's and SRI's above the corresponding general indexes (GPI and GRI, compared to 12 in the case of Indian exports to Brazil). These are sectoral exports therefore that are important in terms of both Indian imports as well as Brazilian exports; or, in other words, they are exports from Brazil to India that are indeed important for both countries. That can be best visualized in the graph 8 below where the 18 sectors are plotted on four different quadrants depending on the relation between PI's and RI's.

Graph 8: Brazilian Exports to India, Participation and Representativeness, 1999-2003



Thus, sectors such as organic chemicals, rubber, non-metal soil and minerals, beverages and silk are considered the "bilateral champions" in Brazilian exports to India since, as seen on the structural graph above, they sit in the quadrant for values above the general participation and representatives indexes: in other words, they are Brazilian exports that are important both for India as an origin of imports as well as for Brazil as a destination of exports in those sectors.

The tendency, however, is not for all sectors to be that way. Some are more important as Indian imports than as Brazilian exports. For example, the automotive sector has a SPI of 3.41 but a SRI of 0.31 indicating that it is very important as a Indian import item but of little relevance as a Brazilian export; likewise with sugar and sugar confectionery where the indexes are respectively 17.56 and 0.24, a great difference indeed. Even for beverages where both index are higher than the general index, the importance of the

item as an import item for India is much higher than the importance of the item as an export item for Brazil since the indexes are 13.20 and 1.91. For these sectors, therefore, India has Brazil as an important source of imports but, in these sectors, India is not an important client relative to all of Brazil's other clients in the world. The only reverse case, where the sector is more important as a Brazilian export than as an Indian import item is silk where the SPI and the SRI are 1.47 and 11.69, respectively.

**TABLE 5: BRAZILIAN EXPORTS TO INDIA, DYNAMISM 1999-2003**

Products	Value	Variation	DI
	US\$ Th.	%	
<b>All</b>	<b>553,131</b>	<b>25</b>	
Organic Chemicals	32,436	42	1.7
Machinery	25,237	12	0.5
Vehicles	19,023	18	0.7
Electro-electronics	14,458	58	2.3
Vegetable Oils	12,469	4	0.2
Iron and Steel	7,937	-2	-0.1
Rubber	7,263	33	1.3
Precision, Medical and Surgical	4,243	24	1.0
Metals and Precious Stones	3,742	14	0.6
Silk	3,696	12	0.5
Perfumery	2,014	56	2.2

Source: ITC, Comtrade, 2005

Variation refers to growth in % of exports from Brazil to India in the 1999/2003 period.

To complete the picture, a brief look at the Dynamism Index (DI) (table 5 above) reveals that the sectors of organic chemicals, electro-electronics, rubber and perfumery have been dynamic as Brazilian exports to India, having grown more than the overall average of Brazilian exports to India in the 1999-2003 period (having thus DI's larger than 1). With this additional indicator, therefore, one can safely single out the sectors where Brazilian exports have a good and promising performance, accumulating positive numbers for all three indexes – PI, RI and DI (participation, representativeness and dynamism) in Indian trades:

**TABLE 6: BRAZILIAN EXPORTS TO INDIA, BEST PERFORMANCE SECTORS**

<b>Organic chemicals</b>
<i>Rubber</i>

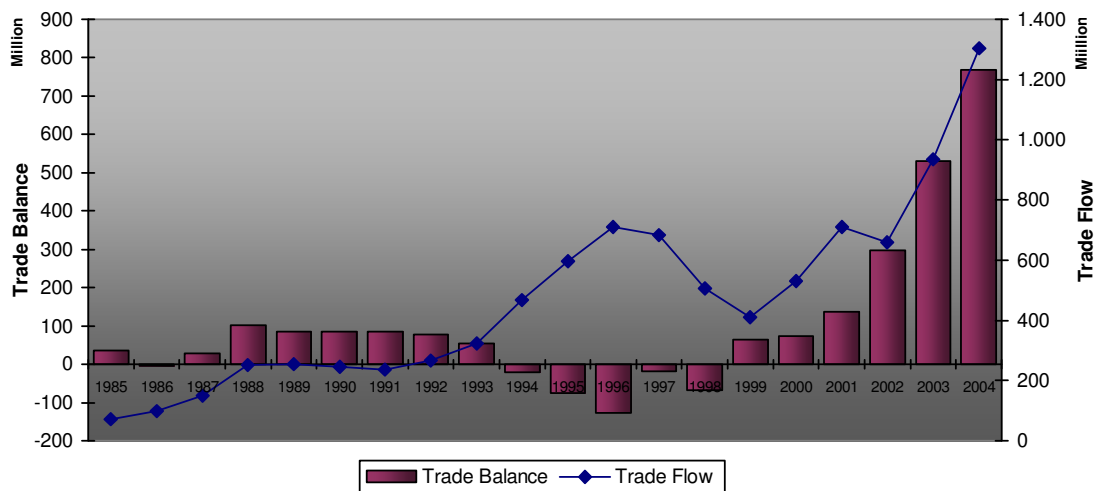
#### Brazil-South Africa Trade

As can be seen in Graph 9 below, just like the bilateral trade with India, trade with South Africa increased significantly in the period following the devaluation of the Real – almost 220%, from around US\$ 410 million to US\$ 1.3 billion in the 1999-2004 period. As compared with India, the trade flow with South Africa was slightly larger in 2004 (around US\$ 100 million) but 80% of that flow is accounted for by Brazilian

exports. In other words, Brazil has had a high and growing surplus with South Africa: almost US\$ 770 million, as compared to a surplus of US\$ 95 with India. The pattern of trade, unlike India, does correlate highly with the main phases of recent economic history - the pre-devaluation stabilization (1994-1999) and the post-devaluation periods (1999-present) – with Brazilian deficits during the former and surpluses during the latter.

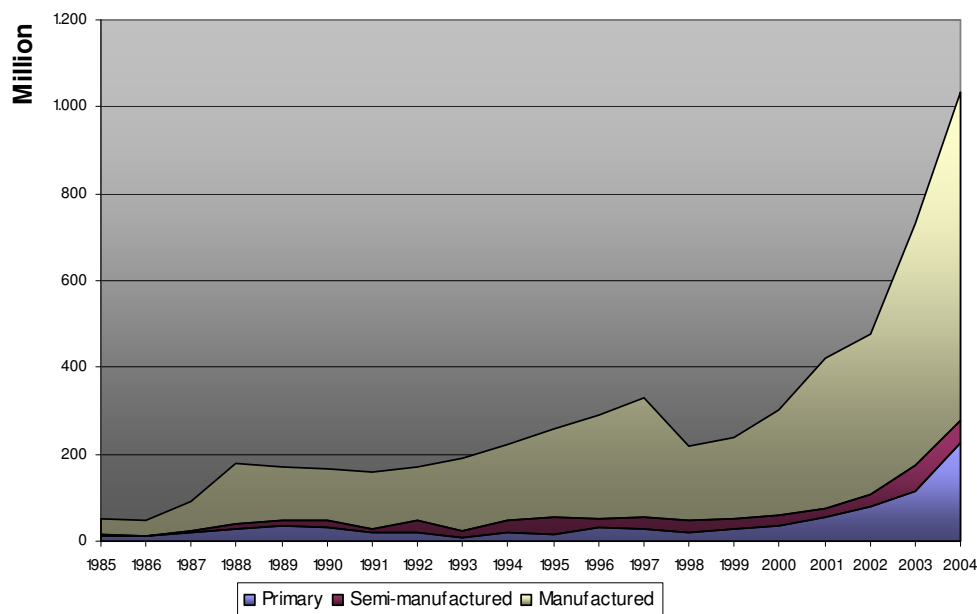
The values are, of course, relatively small, accounting for only 0.76% of Brazil's overall trade flow. The bilateral trade, unlike the patterns for most bilateral trades and for the overall trade balance with the world over time, has been fairly erratic since the mid-90's with surpluses and deficits alternating from year to year – a clear reflection perhaps of the importance of particular products in particular years or of oscillating regulatory, logistical or market conditions impinging upon that trade. Thus, the bilateral trade does not point to Brazilian deficits during the pre-devaluation stabilization period (1994-1999) and Brazilian increasing surpluses ever since as in most other bilateral trades. In fact, it was in 2001 that Brazil had its worst historical deficit with India, to the tune of almost US\$ 260 million.

**Graph 9: Brazil-South Africa, Trade Balance and Flow, 1985-2004**



As can be seen in Graph 10 below, unlike India that has had times when it imported mostly semi-manufactured goods or primary goods, trade with South Africa has been characterized by a predominance of manufactured exports (almost 75% of the total in 2004) for the full course of the bilateral trade's history. Exports have a much lesser sectoral concentration with the ten top products being responsible for only 37% of the total. Half of the ten main export items are automotive in nature, accounting for 18% of total exports. Overall, the automotive sector (chapter 87) accounted for almost 30% of all Brazilian exports to South Africa in 2004.

Brazilian Exports to South Africa, 1985-2004



In 2004, 22% of all exports were primary products, 4.85% were semi-manufactures, and 73% were manufactures. In relative terms, therefore, South Africa is a more important destination for Brazilian primary products than both India and the U.S. while it rivals the U.S. (73 vs. 74%) and is almost twice as important as India as a destination for manufactures.

The table 7 below indicates the 10 sectors, by order of US\$ values, where South African exports to Brazil were above US\$ 1 million in 2003 (according to data from the ITC Comtrade of 2005) and the Participation and Representativeness Indexes for each. The PI and RI for the item "total" correspond respectively to the GPI and GRI (0.35 and 0.56) whereas the individual PI's and RI's to follow are the sectoral indexes.

**TABLE 7: S. AFRICAN EXPORTS TO BRAZIL, PARTICIPATION AND REPRESENTATIVENESS**

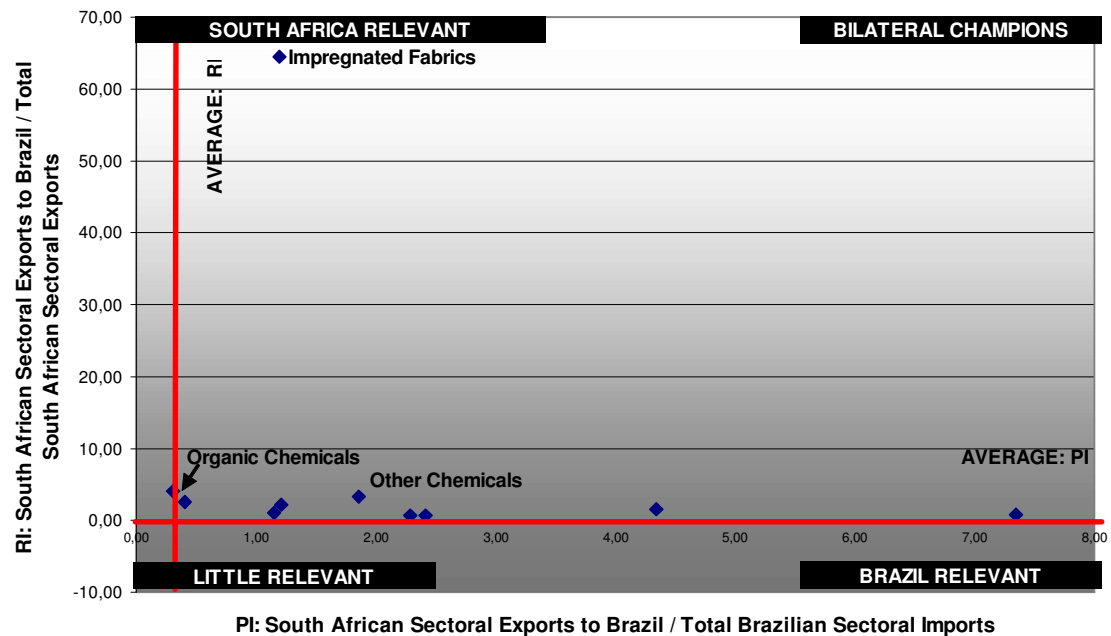
Sectors	US\$ Thousands	PI	RI
<b>Total</b>	<b>177,063</b>	<b>0.35</b>	<b>0.56</b>
Iron and Steel	29,395	7.35	0.77
Aluminum	15,608	4.34	1.51
Organic Chemicals	13,133	0.41	2.58
Minerals	7,525	2.29	0.62
Fertilizers	5,854	0.31	4.03
Paper	5,145	1.15	1.08
Tools	2,322	1.21	2.20
Other Metals	1,472	1.86	3.24

Impregnated Fabrics	1,349	1.19	64.48
Railway Material	1,075	2.41	0.71

Source: International Trade Centre (ITC) Comtrade, 2005

Of the 10 sectors listed in the table, 7 have both SPI's and SRI's above the corresponding general indexes (GPI and GRI). These are sectoral exports therefore that are important in terms of both Brazilian imports as well as South African exports; or, in other words, they are exports from South Africa to Brazil that are indeed important for both Brazil and South Africa. That can be best visualized in the graph 11 below where the 10 sectors are plotted on four different quadrants depending on the relation between PI's and RI's.

Graph 11: South African Sectoral Exports to Brazil, Participation and Representativeness, 1999-2003



Thus, sectors such as iron and steel, aluminum, organic chemicals, minerals, paper, tools, other metals, impregnated fabrics and railway material are considered the "bilateral champions" in South African exports to Brazil since, as seen on the structural graph above, they sit in the quadrant for values above the general participation and representatives indexes: in other words, they are South African exports that are important both for Brazil as an origin of imports as well as for South Africa as a destination of exports in those sectors. In contrast to Indian exports to Brazil, almost all sectors (9 out of 10) South African exports to Brazil above US\$ 1 million are "mutually important" in the bilateral trade.

There are, of course, differences as to which sectoral South African exports to Brazil are more or less important to each side of the bilateral trade. Thus, iron and steel, aluminum,

minerals, paper and railway material, are sectors where South African exports are more important as Brazilian imports than as South African exports *per se* – i.e., the SPI is higher than the SRI. In that context, iron and steel stands out as the main example. Conversely, the sectors of organic chemicals, fertilizers, tools, other metals and impregnated fabrics are more important as South African exports than as Brazilian imports – i.e., the SRI is higher than the SPI. In that context, the main example is the impregnated fabrics sector where the relation is 54 to 1 (or, 64.48 to 1.19).

**TABLE 8: SOUTH AFRICAN EXPORTS TO BRAZIL, DYNAMISM 1999-2003**

Products	Value	Variation	DI
	US\$ Th.	%	
<b>Total</b>	<b>177.063</b>	<b>-8</b>	
Iron and Steel	29.395	-2	-0.3
Aluminum	15.608	-2	-0.3
Organic Chemicals	13.133	28	3.5
Minerals	7.525	-2	-0.3
Fertilizers	5.854	-3	-0.4
Tools	2.322	-12	-1.5
Other Metals	1.472	62	7.8
Impregnated Fabrics	1.349	-6	-0.8
Railway Material	1.075	-9	-1.1

Source: ITC, Comtrade, 2005

Variation refers to growth in % of exports from South Africa to Brazil in the 1999/2003 period.

To complete the picture, a brief look at the Dynamism Index (DI) (table 8 above) reveals that despite the positive results in terms of participation and representativeness, the most prominent exporting sectors do not exhibit a corresponding level of dynamism. Three of the main exporting sectors have seen declines in their sales to Brazil. Iron and steel, alongside aluminum and minerals, have declined 2% a year in the 1999-2003 period while tools fell 12%, railway material 9%, impregnated fabrics 6% and fertilizers 3% annually. Positive performances occurred, with vigor, with other metals (62%) and organic chemicals (28%).

With this additional indicator, therefore, one can safely single out the sectors where South African exports have a good and promising performance, accumulating positive numbers for all three indexes – PI, RI and DI (participation, representativeness and dynamism) in Brazil trades:

**TABLE 9: SOUTH AFRICAN EXPORTS TO BRAZIL, BEST PERFORMANCE SECTORS**

<b>Other Metals</b>
<i>Organic Chemicals</i>

As far as Brazilian exports to South Africa, the GPI and the GRI correspond, respectively to 2.12 and 1.00 while the growth in overall Brazilian exports to South Africa in the period 1999-2003 was of 10%. The table 10 below indicates the 21 sectors, by order of US\$ values, where Brazilian exports to South Africa were above US\$ 1 million in 2003 (according to data from the ITC Comtrade of 2005) and the

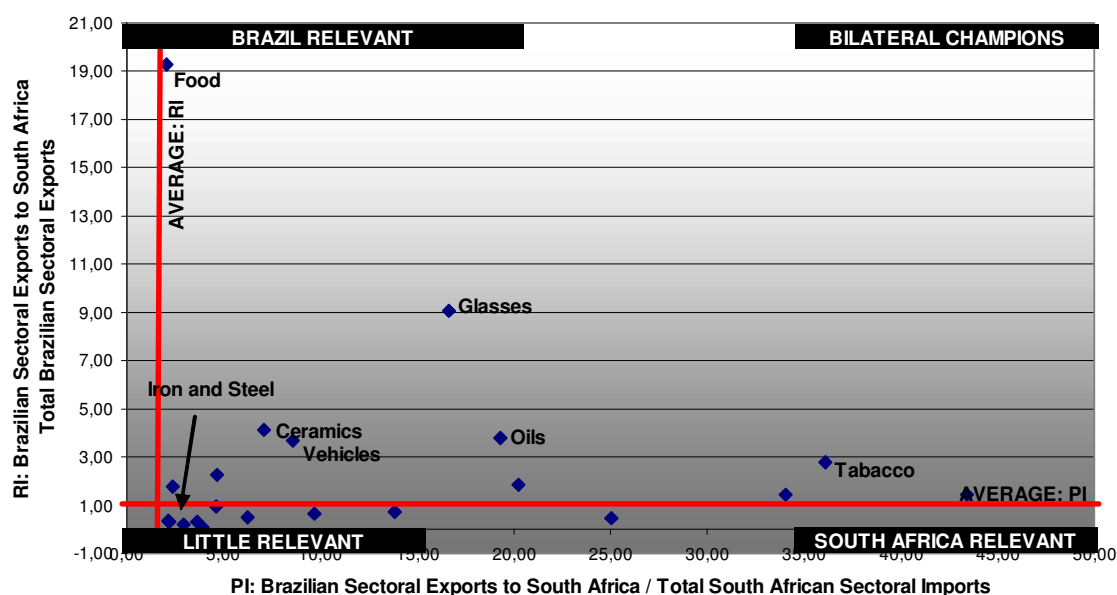
Participation and Representativeness Indexes for each. The PI and RI for the item "total" correspond respectively to the GPI and GRI whereas the individual PI's and RI's to follow are the sectoral indexes (SPI and SRI).

**TABLE 10: BRAZILIAN EXPORTS TO SOUTH AFRICA, PARTICIPATION AND REPRESENTATIVENESS**

Sectors	US\$ Thousands	PI	RI
<b>All</b>	<b>733,146</b>	<b>2.12</b>	1.00
Vehicles	221,332	8.60	3.66
Meat	52,043	43.43	1.43
Vegetable Oils	50,977	19.30	3.81
Tabacco	30,408	36.11	2.79
Mineral	25,958	13.87	0.71
Glasses	22,911	16.67	9.08
Plastics	20,885	2.40	1.78
Leathers and Skins	19,607	20.25	1.85
Paper	15,631	34.03	1.44
Ceramics	14,919	7.11	4.13
Iron and Steel	9,598	2.92	0.20
Aluminum	9,526	9.71	0.63
Paper Pulp	7,811	25.04	0.45
Wood and wooden works	6,647	3.63	0.32
Shoes	5,911	2.17	0.36
Stone works	4,267	4.62	0.94
Foods	1,896	2.06	19.26
Sugar and Confitery	1,786	3.92	0.08
Special Fabrics	1,738	4.65	2.24
Tools	1,216	6.23	0.51
Chocolates	1,009	2.20	0.31

Of the 21 sectors listed in the table, only 10 have both SPI's and SRI's above the corresponding general indexes (GPI and GRI, compared to 9 out of 10 in the case of South African exports to Brazil). These are sectoral exports therefore that are important in terms of both South African imports as well as Brazilian exports; or, in other words, they are exports from Brazil to South Africa that are indeed important for both countries. That can be best visualized in the graph 12 below where the 21 sectors are plotted on four different quadrants depending on the relation between PI's and RI's.

Graph 12: Brazilian Sectoral Exports to South Africa, Participation and Representativeness, 1999-2003



Thus, sectors such as glasses, vegetable oils, tobacco, paper pulp, vehicles and ceramics are considered the "bilateral champions" in Brazilian exports to South Africa since, as seen on the structural graph above, they sit in the quadrant for values above the general participation and representatives indexes: in other words, they are Brazilian exports that are important both for South Africa as an origin of imports as well as for Brazil as a destination of exports in those sectors.

There are, of course, differences as to which sectoral Brazilian exports to South Africa are more or less important to each side of the bilateral trade. Thus, with the exception of the food sector, for all other sectors with more than US\$ 1 million in annual exports to South Africa, Brazilian exports are more important as South African imports than as Brazilian exports *per se* – i.e., the SPI is higher than the SRI. The case of meat, for example, is a stark illustration of that type of relation since Brazilian exports account for 43.43% of South Africa's meat imports (SPI) while they account for only 1.43% of all Brazilian meat exports. Generally speaking therefore, Brazil seems to be an important supplier for South Africa, relative to other world suppliers, in the sectors where it exports more than US\$ 1 million while South Africa is a relatively less important buyer for Brazilian exports than other world buyers.

TABLE 11: BRAZILIAN EXPORTS TO SOUTH AFRICA, DYNAMISM 1999-2003

Products	Value	Variation	DI
	US\$ Th.	%	
<b>All</b>	<b>733,146</b>	<b>10</b>	
Vehicles	221,332	11	1.1
Meat	52,043	26	2.6
Vegetable Oils	50,977	18	1.8

Plastics	20,885	10	1.0
Iron and Steel	9,598	10	1.0
Wood and wood works	6,647	10	1.0
Stone work	4,267	11	1.1
Chocolates	1,009	18	1.8

Source: ITC, Comtrade, 2005

Variation refers to growth in % of exports from South Africa to Brazil in the 1999/2003 period.

To complete the picture, a brief look at the Dynamism Index (DI) (table 11 above) reveals that the sectors of vehicles, meat, vegetable oils, stonework and chocolates have been dynamic as Brazilian exports to South Africa, having grown more than the overall average of Brazilian exports to South Africa in the 1999-2003 period (thus, a DI's larger than 1). With this additional indicator, therefore, one can safely single out the sectors where Brazilian exports have a good and promising performance, accumulating positive numbers for all three indexes – PI, RI and DI (participation, representativeness and dynamism) in South Africa trades:

**TABLE 12: BRAZILIAN EXPORTS TO SOUTH AFRICA, BEST PERFORMANCE SECTORS**

<i>Vehicles</i>
<i>Meat</i>
<i>Vegetable Oils</i>

### IBSA and Foreign Direct Investment

Alongside trade, investment constitutes a crucial aspect of global economic relations and could not be absent from an IBSA purview such as the one herein proposed. In an ideal world, agreements such as the ones pursued by IBSA partners should result not only in increased exports and imports but also in greater and better investment flows across the three countries. In fact, trade is nothing but an important element in the broad spectrum of investment relations: "good" trade should facilitate investment by permitting investors to invest, produce and sell products and services where they have a competitive edge and in the most efficient way possible. IBSA's success should clearly be measured against the effect it may have on spurring greenfield and other investments where that has only occurred sparsely for a number of reasons.

The case of intra-IBSA investment is indeed incipient. It is, therefore, interesting to probe into whether the reasons for such a state of affairs have to do mostly with distances, culture or the policies of major multinationals, or whether there are "indigenous" reasons that scare away investment or at least do not contribute to attracting it. The table below elaborated by the World Bank gives a good idea of some comparative elements relating to the investment climate in the three IBSA countries – elements that are relevant for any investor, including those from IBSA countries themselves.

**TABLE 13: BUSINESS ENVIRONMENT INDICATORS, 2004**

Indicators	Brazil	India	South Africa	OECD Average
<b>Starting a Business</b>				
Number of procedures	17	11	9	6
Time (days)	152	89	38	25
Cost (% of income <i>per capita</i> )	11.7	49.5	9.1	8.0
Min. capital (% of income <i>per capita</i> )	0.0	0.0	0.0	44.1
<b>Hiring and Firing Workers</b>				
Difficulty of Hiring Index	67	33	56	26.2
Rigidity to hours Index	80	20	40	50.0
Difficulty to Firing Index	70	90	60	26.8
Employment Rigidity Index	72	48	52	34.4
Firing Costs (weeks of wages)	165	79	38	40.4

Source: The World Bank, 2005

The challenges of launching a business in IBSA countries are pretty apparent from the table, albeit to different degrees across countries. In all but three of the indices listed in the table does at least one IBSA country fare better than their OECD counterparts. The best result in that context relates to the requirement for a minimum deposit to obtain a business registration, something which is at 44.1% of gross national income (GNI) in OECD countries but does not even exist in their IBSA counterparts. OECD countries have a higher rigidity in their regulations on working hours than India and South Africa while firing costs tend to be higher in the OECD than in South Africa.

For all other business environment indicators, IBSA countries fare significantly worse than the OECD. Of nine indicators listed in the table, Brazil has the worst numbers in six of them (tied in two of them with India) while South Africa has the best numbers in six indicators. The most striking numbers are the 152 days on average to start a business and the 165 weeks of wages when firing employees that entrepreneurs may expect to go through in Brazil. In India, the high number relates to the difficulty to dismiss a redundant worker which stands at 90 (as opposed to 26.8 in OECD countries). As can be seen, even though the three countries can differ on specific indicators and indices, the overall picture is not quite an "investment-friendly" one for the IBSA "region". An important corollary is that for IBSA countries that are relatively "newcomers" in the FDI universe and do not have the same capacity and structure to back their investments as OECD countries do, the IBSA business environment makes it all the more difficult for "intra-zone" investment to occur.

According to Brazil's Central Bank, direct investment undertaken by Brazilians overseas totaled US\$ 44.7 billion in 2003, of which US\$ 5.946 billion, or 13% of the total, referred to portfolio investment. There have been no recordings of Brazilian investments in either India or South Africa, the last entry referring to a value of US\$ 8 million in South Africa in 2001. The table below demonstrates the importance of tax havens such as the Cayman and Virgin Islands or the Bahamas as destinations to Brazilian investments, most of which ultimately find their way back to the country *via* new investment opportunities.

**TABLE 14: BRAZILIAN INVESTMENT OVERSEAS - US\$ MILLION**

Country of Destination	2001	2003
Cayman/Virgin/Bahamas	27,053	28,770

Mercosul	4.874	4.359
United States	1.401	2.100
Spain	1.657	1.775
South Africa	8	-
India	-	-
Total	42.584	44.769

Source: Central Bank of Brazil, 2005

It should be noted that Mercosul is more important as destination for Brazilian investments than the United States. More than 200 firms have established in Argentina or Uruguay *via* a FDI in the industrial and service sectors. This stands in stark contrast with the overall conservative approach by Brazilian investors to investments in other parts of the world, including India and South Africa.

What little there is of Brazilian investments in IBSA partners, it all relates to South Africa and with a particular focus on the transport and mining sectors. In some cases, investments reflect strong relations between Brazilian and South African firms, whether local or multinational. One example of a Brazilian Greenfield investment is the bus manufacturer Marcopolo that has established a factory in South Africa and produces 700 units per year – the highest level of bus production in Africa as a whole. A general tendency for Brazilian investments in South Africa and vice-versa is for investors to resort to local funding – which may also explain the low numbers officially registered at the Central Bank.

In the financial markets, there is a generalized lack of knowledge regarding investment opportunities so that short-term investments also tend to go by the wayside in Brazil-South African relations. The lack of market information accounts for the almost inexistent presence of Brazilian financial institutions in South Africa, including investors in the Johannesburg stock market.

There are both structural and localized problems that undermine investor appetite in South Africa. The lack of information and knowledge, the lack of confidence in the market, the lack of appreciation for business opportunities, all have been mentioned in the interviews as reasons for no interest on the part of Brazilian investors in South Africa. More specifically, there is a perceived lack of information on joint ventures and the participation of the State in strategic projects in energy, transports and telecommunications. Among the firms that responded about South Africa, 15% made reference to great bureaucratic difficulties, too many procedures to start a business, rigidity regarding labor relations and a complex tax regime as notorious barriers to business development.

As to India, there is no recorded relevant Brazilian direct investments. Around 20% of those interviewed referred to entry costs, insecure procedures, excessive bureaucracy and lack of regulatory transparency as major obstacles. An equal portion of those interviewed pointed specifically to lack of copyright and other intellectual property protection as a major disincentive to investment.

Regarding inward FDI from India and South Africa, the values are also very small. Brazil has been a major recipient of FDI, having been second only to China in the developing world. India and South Africa have not, of course, been amongst the biggest

investors in Brazil – a trend which obtains the world over as most of the FDI that actually sees the light of day is by and among OECD countries.

**TABLE 15: FDI CHAMPIONS, 2003**

<b>Ranking</b>	<b>Value (US\$ bi)</b>
1-Luxembourg	87
2-China	53
3-France	47
4-United States	30
5-Belgium	29
6-Spain	26
7-Ireland	25
8-The Netherlands	20
9-Italy	16
10-United Kingdom	14
16-Brazil	12

Source: UNCTAD, World Investment Report, 2004

According to the Central Bank of Brazil, the FDI stock from India and South Africa, albeit small by world standards, has increased significantly in the 1995-2000 period, a trend which has continued ever since. As the table below indicates, India has a stock almost twice as big as South Africa, having gone from 0 in 1995 to US\$ 45.9 million in 2000, and its FDI flows have been growing consistently in the years 2000 – from an annual flow of US\$ 3.38 to 14.14 million, or an increase of almost 320% in annual values. With that increase, India's FDI stock in Brazil is reaching over US\$ 70 million. South Africa's FDI stock in Brazil has also grown remarkably, from US\$ 2.07 million to US\$ 26.1 million, or an increase of almost 1,200% in the 1995-2000 period. Its flows peaked at US\$ 8.27 million in 2003 and declined last year to US\$ 3.59 million, still contributing another US\$ 22 million to the country's FDI stock (almost doubling it in four years). While most of the South African investment relates to mining, the most important sector for Indian FDI in Brazil is pharmaceutical.

**TABLE 16: FDI IN BRAZIL - US\$ MILLION**

<b>Origin</b>	<b>India</b>	<b>South Africa</b>	<b>Total</b>
<b>Stock</b>			
<b>1995</b>	0	2.07	41,695
<b>2000</b>	45.9	26.1	103,014
<b>Flows</b>			
<b>2001</b>	3.38	5.71	21,041
<b>2002</b>	4	5.57	18,778
<b>2003</b>	7.43	8.27	12,902
<b>2004</b>	14.14	3.59	20,265

Source: Central Bank of Brazil, FIRCE, Foreign Capital Flows, 2005

Future Business Plans: Where do India and South Africa Factor in?

Around 30% of the firms interviewed export or intend to export to South Africa. There exist already common cooperation projects in the areas of environment and biotechnology applied to mining, as exemplified by the gold purification and environmental sustainability processes. Ethanol is also the object of study in both markets.

In relation to India, 10% of those interviewed indicated intention of forming future partnerships in the pharmaceutical sector with a view to producing medicine in Brazil with Indian raw materials as well as to jointly engaging in production of drugs intensive in natural products originated in Brazil. Generally, around 10% of all interviewed intend to start doing business with India at some level. On the cooperation front, the software sector was widely mentioned as a good candidate as the two countries tend to be compatible in their current approach to trade and investment in the sector.

Fully 35% of those interviewed said that any trade and/or investment entry into India or South Africa necessarily have to be undertaken in a very cautious and well-thought-out manner, without great financial exposure. Trade fairs and missions were mentioned as the most reliable way to promote closer economic relations with India and South Africa, particularly insofar as the search of local representatives (local distribution network) was concerned.

A firm in the juices segment of the food industries pointed to certain market conditions – as opposed to government policies or bureaucratic barriers – as deterrents for trade and investment with IBSA countries. The firm said that in South Africa, for example, ready-to-drink juices are the object of much competition with the presence of many local and imported brands, making it difficult for companies from Brazil that have to face transport and other costs to enter the market successfully. In India, the main problem is the relatively low cost of living and the rupee's effective purchasing power which make the firm's product expensive and thus restricted to a small share of the population. In both cases, a crucial matter is to find a local partner that has both the financial capacity and the distribution channels necessary to allow a reasonable coverage of the market.

### The Multinational Perspective

Another aspect to be considered when addressing IBSA trade and investment is the place of multinational companies (MNCs) in that context. In Brazil, MNCs play a crucial role in the economy, contributing significantly to growth and job creation. MNCs often effectively become technological hubs within economies, bringing to national markets technological state-of-the-art developments and management techniques. MNCs often invest in countries like Brazil with a view to focusing on exports, thus contributing also significantly to the expansion of export platforms in emerging markets. Much of the success in that context will have to do therefore with the overall policy environment - particularly insofar as the trade and investment divide is concerned - that host countries manage to muster. Large emerging countries like Brazil and India tend to be favored by investment even in the absence of a clear, transparent, open-market, and investment-friendly regulatory regime. This is however bound to

continue to change so that even large internal market countries may need to worry a little more about attracting investment.

Of the ten sectors surveyed in the present study, MNCs figure as the leaders in five: automobiles and auto ancillaries, chemicals (especially pharmaceuticals), agro-based products (fruit juices, soya etc), machinery (capital goods and electronics) and metals. In sectors such as automotive or electronics, foreign firms virtually dominate the whole national market. Of the ten sectors surveyed, the only two sectors not to exhibit significant FDI as a norm in Brazil are textiles alongside leather and leather products.

It is also widely known that the organizational philosophy and structure of MNCs is fully different than local firms. Decision-making, particularly, is normally undertaken at headquarters, by executives or boards that are not located in host countries. Subsidiaries and affiliates, therefore, tend to have only limited autonomy to decide and act, in most cases having to accede to recommendations or outright instructions from overseas. Market segmentation of the global market is therefore undertaken at headquarters and not locally. This, as many mentioned, is particularly relevant for IBSA countries since they tend to host many of the same MNCs in a variety of sectors.

A preliminary conclusion from contacts with MNCs operating in Brazil is that an initiative such as IBSA must at some point focus on multinational investment. All three countries at some level compete for FDI from the same sources and the same MNCs also compete among themselves for attractive investment regimes across countries such as the three IBSA members. Local executives of major MNCs tend to agree that a high-level dialog amongst MNCs and the three governments might not be a bad idea since only then might one be able to ascertain whether IBSA as an initiative might have a favorable impact on FDI – particularly in industries that operate in some or all of the IBSA countries.

## **Business Awareness**

### Awareness and Attitude towards Government's Trade Promotion Policies

Trade policy as such has gone through a major qualitative change during the nineties in Brazil. Up until then, much of the trade regime was centralized in a single agency, the "*Carteira de Comércio Exterior*" (CACEX), that was responsible for all aspects of trade policy, including trade operations, remedies, promotion and negotiations. CACEX's existence tracked broadly with the most intensive period of import substitution in Brazil (post-WWII until the end of the eighties) which made it easier for a country the size of Brazil to have it all centralized in one place. Import substitution required mostly the *administration* of trade and not much *elaboration* or effective *policy making* took place: it was the "reign" of CACEX and the centralized trade regime. Import substitution dictated the maintenance of a high tariff barrier alongside the subsidization of "infant industries" or industries that for one reason or another, including political influence, would manage to be favored by the visible hand of government.

Things would begin to change during the 1990's when the Brazilian economy underwent a couple of major liberalization bouts and Brazil's approach to the world began to incorporate a much more sophisticated trade and integration strategy. Mercosul would be created in 1991 and the government would decentralize its trade apparatus, something which would be deepened with the advent of the Free Trade Area of the Americas (FTAA) negotiations and the inauguration of President Fernando Henrique Cardoso in 1995. Mercosul, the FTAA negotiations and the implementation of the WTO Agreements would prove enough for the system to continue its reform during the second half of the nineties. Trade promotion would be one of the most important by-products, including the creation of a specialized agency fully devoted to the matter – APEX.

Although it is very common for the private sector to complain about the lack of a clear, transparent and forward-looking trade policy on the part of the government, it is undeniable that a few important measures regarding Brazil's trade and trade regime have been put into practice in the last few years such as the "Export Promotion Program – PROEX" (made famous by the Embraer case against Bombardier of Canada), the elimination of value-added tax on exports of semi-manufactures and a continuous revamping and overhauling of the trade regime alongside capacitation and awareness programs vis-à-vis the private sector. Today the dissemination of trade "intelligence" is perhaps the best it has ever been, particularly in relation to the small and medium newcomers into the trade scene who have only now understood the strategic importance of foreign trade for their own sustainability in the market.

Most of the current complaints from the private sector regarding the government's trade policy focus on lack of a few important elements: information, transparency in policy, consultations with those interested (the private sector itself) and, finally, a clear strategic planning regarding measures taken or even the negotiations of trade agreements. Trade policy is still perceived as excessively random given its overall importance for the national economy. Entrepreneurs also often point to too many intervening ministries and agencies in trade policy as an additional confusing factor, some going as far as to suggest that trade has become overly entangled in matters of a strategic, geopolitical nature when in fact it should stay away from those realms – the strategic and the geopolitical.

In any case, for 35% of responding firms, a deepened knowledge of IBSA markets is essential before any formal agreement can result in concrete benefit for all involved. Around 20% of the interviewed said that they rely on federations of industries (state-level) and chambers of commerce for that kind of commercial intelligence while another 10% pointed to government as the main protagonist in that context. For those that rely on private sector organizations, the experience has been far from satisfactory as exemplified by the responses of a steel firm. The firm said that market research can normally be commissioned from certain chambers but that the cost (US\$ 8,000) was too high given the quality of the final product. For 35% of the interviewed fairs and missions are the crucial form of approach markets such as India and South Africa. Of the interviewed there seemed to be little enthusiasm for the realization of a possible IBSA Trade Fair.

One quarter of firms interviewed also recognized the importance of the reduction and/or elimination of customs duties as a means to gain access to the Indian and South African markets. However, those who mentioned tariffs also pointed to the need to exert great caution when negotiating with countries that enjoy better market conditions and lower production costs than Brazil – a clear reference to India and South Africa alongside China (clearly, as the main culprit).

#### Awareness of IBSA Initiative

It makes sense that the Brazilian, Indian and South African governments seek to improve their commercial relations. IBSA could be an important vehicle in that respect but one is not yet too certain whether the initiative could be as fruitful on promoting trilateral trade as it obviously can in bringing the three countries together on strategic issues in the international arena. The most strategic "game in town" in that context is the WTO Doha negotiations and there the three countries have indeed moved some distance toward common positions and an impressive leadership role, particularly in the agricultural negotiations with the creation of the G20. One of IBSA's implicit challenges, therefore, is to prove to the world that cooperation and coordination can effectively extend to trade and investment among themselves, and not just in respect of the rest of the world.

In agriculture, the three countries tend to have important export interests, as exemplified by meat products, soya, sugar, coffee and cotton in the case of Brazil, cotton, sugar and cereals in the case of India and sugar and oils for South Africa. Yet, the mix of offensive and defensive interests across the three countries is more complex than is usually assumed and continues to be tested in the Doha negotiations.

In industrial products, or the NAMA negotiations, there have been important coordinated steps taken, as was the case with the ABI tariff-reduction formula where Brazil and India, alongside Argentina, presented a joint proposal on a non-linear approach that takes into account average bound tariffs and links related coefficients to the overall level of ambition in the Round – in other words, to real movement in agriculture. This has been a major cooperative effort on the part of two IBSA countries that differ considerably as to their tariff structure, levels of bindings, number of bindings, etc.

On the trilateral trade, however, very little has effectively taken place. Since December last and with the final Ministerial signing in March, the Mercosul-India Preferential Trade Agreement has been concluded – albeit still in the ratification process in both parliaments. Also in December Mercosul and South Africa concluded a PTA. In both cases, the level of ambition was relatively low given that the agreements aim solely at the exchange of tariff preferences for a very limited number of items: 450 in the case of Mercosul-India, around 1,000 in the case of Mercosul-South Africa. Yet, there has been renewed talk regarding the deepening of the current understandings with a view to shifting the focus to the conformation of a free trade area in both cases.

There is very little awareness of the IBSA initiative in Brazil. When entrepreneurs know about it, they often confuse it with the Mercosul+1 agreements with the two IBSA

partners, as if the Mercosul and IBSA initiatives were in effect all but one. It should be noted that the private sector, for the most part, does not feel as if they were properly consulted regarding the Mercosul agreements and now see with great suspicion any related initiative – as IBSA is at best perceived. In the case of India, particularly, an automatic correlation is often made with China, both countries being perceived as highly efficient competitors in world markets and, therefore, an extremely powerful force to contend with in the national market – particularly in the context of any further preferential openings *via* Mercosul or IBSA itself.

One could certainly generalize on the basis of the interviews as well as the media coverage and just plain hearsay that the current perception in Brazil regarding IBSA and trade with countries that, like Brazil, have only recently come out of import substitution policies and currently compete for access to the world's most important markets (U.S., E.U., especially), is something to be monitored and studied but not yet necessarily "promoted", "deepened" or "facilitated". The fact is that IBSA partners tend to be *competitors* and not *clients* in relation to each other. The real clients sit in the Northern Hemisphere still and the private sector is particularly sensitive to bouts of diplomatic enthusiasm that may result in fiercer adjustment costs than they already have to withstand routinely in their own market due to "self-imposed" bureaucratic, regulatory, tax and logistical deficiencies.

75% of the interviewed did not even know about the initiative while for 60% of the firms there was no interest whatsoever in it.

#### Expectations from IBSA Initiative

There are important differences in the opinion of those interviewed in relation to trade with India and trade with South Africa. One could even affirm that there is a visible preference for further deepening of the commercial relationship with South Africa as opposed to India. Only two firms from the pharmaceutical sector expressed an interest in tariff reduction exercises between Brazil and India. Six firms, including one in the mechanics sector, went as far as to characterize trade with India as highly risky by virtue of perceived triangulation possibilities and dumping practices – particularly given an equally powerful perception that India may be much more lax in the application and enforcement of minimal labor and environmental standards – something which is widely regarded as an unfair competitive edge for Indian products in the Brazilian markets. In other words, Brazil's opposition to including labor and environmental standards in regional initiatives such as the Free Trade Areas of the Americas (FTAA) seems to be undergoing a major transformation in the minds of the private sector whenever the agreement has to do with India (and China, as well, of course).

Twenty percent of those interviewed would be in favor of moving forward toward freer trade with South Africa as long as on the basis of clear trade rules that avoid triangulation. Another 20% also mentioned the WTO negotiations, particularly in regard to trade rules, as a priority, including for coordination among IBSA countries. As far as demands are concerned, sugar stands out as a common interest among the three countries, alongside, once again, fair trade rules. The emphasis on rules, in several cases, referred specifically to: the end of subsidies for sugar production and export; rules

against unfair trade; rules against triangulation. Some firms specifically mentioned also the need to seek tariff reductions in the area of cosmetics among countries with a "correct" application of rules of origin – what appears to be the demand for a sectoral negotiation on cosmetics at the WTO, in the context of the NAMA negotiations.

Around 70% of those interviewed mentioned the United States and Latin America as priority markets, pointing to the physical proximity, the competitiveness of the national products vis-à-vis those markets and relevant operational facilities. As the questions were general in relation to trade agreements, leaving it up to the interviewed to mention those that were important to their interests, the answers were particularly revealing. Thus, half of the firms interviewed mentioned explicitly the Mercosul-Andean Community agreement as a pact that needs to be deepened<sup>1</sup> while a little over one third of the firms made references to the need to seek an agreement with the U.S. and the countries of Central America and the Caribbean. Around 20% of those interviewed are in favor of a Mercosul-E.U. agreement.

Regarding IBSA specifically, around one third of the firms mentioned that a lowering of South African tariffs would by itself be a good deal. Overall, only 10% were in favor of the government's IBSA push, all firms in the agribusiness sector. Even then, the emphasis of this 10% of the sample seems to be on the value of cooperating and forging alliances with important countries such as India and South Africa as an instrument to gain market access around the world – and not just in IBSA countries themselves.

A steel firm acknowledged the importance of American and European markets but pointed to how competition in these markets tends to be intense as competitors often have access to better technology, easier financing conditions, and lesser administrative, tax and logistical burdens. IBSA can be very interesting in that context, particularly if and when it becomes a priority for federations and chambers of commerce in the three countries. Another firm, this one in the juice segment of the food industries, said that exports to countries in the South have grown considerably due to lesser competition in their markets and a relatively high demand for a host of products. In addition, tariffs tend to be very high in these countries and their integration with the world economy is still minimal: trade agreements could be of great interest to eliminate barriers to Brazilian exports, therefore.

The existing dichotomy between geopolitical *versus* trade objectives is becoming a serious national issue in Brazil. The private sector objects intensely to commercial agreements that do not generate commerce or, worse yet, that may produce an unbalanced *quid-pro-quo* between increased competition in the national market and increased access to international markets.

### **Barriers and Key Concerns**

Trade with India and South Africa is first and foremost perceived as a challenge - and not one against the background of good commercial opportunities. Too often and too quickly in the interviews the barriers, the difficulties and the obstacles to trade with IBSA partners were mentioned as if to justify the generalized lack of knowledge, interest or both in the initiative. Among barriers and concerns mentioned, there were

those that are present in Brazil itself, including government strategies and logistical costs.

### Government Strategies

Although a sensitive subject where firms prefer not to speak on the record, the interviews clearly demonstrated that the private sector is sensitive to government initiatives where trade and investment are just a part of a much broader foreign policy strategy. IBSA looms large in that horizon as it is perceived as a crucial element in the current government's strategy to forge political alliances with major developing and emerging countries.

For many entrepreneurs, there is a lack of clarity of purpose in the government's approach to trade agreements. For the private sector, trade agreements are supposed to achieve greater access to markets of interest alongside a friendly and secure environment for investments. Any other element may be perceived as secondary or plain irrelevant as may be the case with the distant universe of geopolitical strategies.

In the case of small and medium enterprises, the high priority continues to be the internal market and, at most, the closest external market. Thus, one can hardly imagine that entrepreneurs that can be successful in South America will be much concerned with expanding to India or South Africa unless there is an effective momentary opportunity or it fits somehow in the medium to long term plans of the firm (such as seems to be the case with the pharmaceutical sector). A firm that has supplied services in India in the metals sector admitted that it only took on the job because, in addition to the financial interest, there were no travel or marketing costs involved (a particularity to some services).

In the case of large enterprises, trade and investment decisions may be directed towards servicing certain specific markets, including *via* production facilities present in a foreign, and not the Brazilian, market. Larger firms may also decide on the basis of horizontal or vertical strategies that may be influenced by factors such as the easiness of sub-contracting, supplying and assembling or the need to avoid competition in certain segments or sectors. In other words, in addition to region or country-specific conditions, much of the decision-making may be influenced by the overall approach adopted right at the top of the firm – often in the case of larger, multinational firms at the international headquarters. It is widely recognized that a major influence on international trade is the decisions taken by major international firms as to how they want to source in or out their inputs and final products. Trading with India or South Africa, for example, may not be in the plans of a multinational firm that, albeit present in Brazil, has as a "global" strategy buying from Asian sources for its subsidiaries in India or South Africa.

When asked what they would do to improve trade and investment amongst IBSA countries firms had various responses. A few firms mentioned preferential agreements as an important objective so as to achieve the reduction of tariffs in India and/or South Africa (firms in the textile, pharmaceuticals, juice and cosmetics segments). A firm in the sugar segment pointed to the need for an investment partnership while a shoe and

leather producer was particularly concerned with means to deal with unfair trade and injurious practices.

### Brazil Cost

The term "Brazil Cost" has been a very common expression used in Brazil to refer to a host of doing-business, making-investments obstacles of an indigenous nature such as: logistics, transport, communications, energy, tax policy, labor and social cost, etc. It is widely recognized that a big part of the problem with exporting or investing overseas is internal since firms cannot become sufficiently competitive in the presence of so many "additional" costs to their production and distribution as those present in the Brazilian market itself.

Thirty percent of those interviewed said that the current exchange rate is enough to prevent them from considering any forays into Indian or South African markets. Other 3 firms considered logistical costs to be prohibitive while 50% of those interviewed mentioned also the Brazilian tax burden as a major deterrent for trade and investment with India and/or South Africa. There is also a generalized perception that competition with Indian or South African products may be "uneven" as the costs in India and South Africa may be much lesser than is the case in Brazil, including, for example, access to trade and investment financing.

### Tariffs

High import tariffs were mentioned by 15% of those interviewed as major barriers to increased economic relations with India and South Africa. This may be a good sign since IBSA and the Mercosul+1 agreements may indeed address such barriers through systematic tariff-reduction negotiations. In other words, if tariffs are perceived as obstacles to increased trade, then trade may indeed be generated if IBSA-related agreements do indeed achieve a major reduction in their levels.

The table below illustrates the case of South Africa.

**TABLE 17: SOUTH AFRICAN TARIFFS**

<b>Sector</b>	<b>Code</b>	<b>South African rates</b>
Food, prepared, bovine meat	1601	40%
Pharmaceuticals	3004	free
Leather, leather products	4202	30%
Textile, cotton	5208	22% / 27% » 100cents per kg
Apparel - underwear	6108	40 % 54% » 5810 cents per kg
Shoes	6404	30% 500 cents per pair
Steel – rolling bridges	7308	15%
Machinery, electrical transformers	8504	10%
Transport, cars, other vehicles	8703	20% to 43,5%
Wooden furniture	9403	20%

## Culture

Cultural difference also figured in the responses as an important element when considering trade and investment with India and South Africa. In relation to South Africa, 15% of the firms admit to difficulties relating to culture but another 20% said that they operate very effectively in the South African market, that South African firms are very professional, that banking services are more than satisfactory and that they never had problems that could be somehow attributed to cultural differences between Brazil and South Africa. Only one firm, in the electronics sector, highlighted cultural differences with South Africa, and that in the context of a particular service rendered in that market.

As to India, 80% of the firms did indeed mention culture as a potential obstacle, pointing to the following elements, among others: style differences, little familiarity with Indian customs, lack of affinities that may help in signaling business possibilities, lack of knowledge regarding proximity and intimacy, general lack of trust and a very high indeed degree of ignorance regarding Indian culture as a whole. One firm said that cultural differences with India are not in any way a bigger problem than with other countries. For one firm Hindu culture did indeed prevent its penetration into the Indian market.

## Freight

Around 20% of those interviewed pointed to freight conditions as a major deterrent for trade with India and South Africa. Freight costs are allegedly high for primarily two major reasons. Firstly, there is no regular traffic with India which is not included in the overall Asian routes from Brazil that tend to favor China, Japan and Korea. Secondly, many combined cargo ships (bulk and containers), even when they go by India do not stop at Indian ports given the scale of orders to that destination.

For two entrepreneurs (minerals and paper pulp), high freight rates can only be compensated *via* supply demand and/or scale. Costs tend to be high also because trades to those countries cannot be transported in single ships, with the exception of petroleum where trade has been bullish for some time now. If there is traffic with other countries along the way, freight rates could fall since the chances of a to- and from-cargo increase proportionately. Nevertheless, still, in the Brazil-India routes the possibility of real freight rate reduction continues to be dim. One firm said that insurance values can also be prohibitive given safety levels in certain parts of the route.

One firm prefers to use air transport but the cost is also very high so that trade is only worth it by those means when the cargo is of a very high value-added nature.

**TABLE 18: FREIGHT CONDITIONS, BRAZIL/SOUTH AFRICA/INDIA**

Routes	Transport in days	Days at the port	Type of Cargo	Approximate Cost
Santos- Cape Town	10	2 to 3 days	Bulk and container	US\$ 1,500
São Paulo- Johannesburg	Hours	2 to 3 days	Direct flight	Not informed
Santos- Mombay	30 days	4 to 6 days	Bulk and container;	US\$ 2,300

refrigerated ship

US\$ 2,800

**Source:** Own research and elaboration

One can firmly conclude that the type of trade, the distances and the consequent freight costs constitute important obstacles to trade with India and South Africa.

### Entry Costs

Entry costs into the Indian and South African markets tend to be the most important barrier identified by those interviewed. They occur at three different levels, namely: 1) costs relating to exporting to Indian and South Africa; 2) costs relating to the registration of products, the conclusion of technology transfers or production licenses; 3) costs relating to direct investments. The interviewed concurred on how to export a firm has to count on at least one trip, the mailing of samples, a major banking negotiation and registration at relevant events, particularly business fairs.

As can be seen in the table below, costs tend to be higher for India as compared with South Africa.

**TABLE 19: ENTRY COSTS, SOUTH AFRICA/INDIA**

<b>Material</b>	<b>E.U.</b>	<b>South Africa</b>	<b>India</b>
Documentation	R\$ 3.25 to 6.75	R\$ 3.25 to R\$ 6.75	3.25 to R\$ 67.00
Samples- 1 kg	R\$ 50.00 to R\$ 60.00	R\$ 60.00 to R\$ 75.00	R\$ 60.00 to R\$ 132.00
Merchandise- 20 kg	R\$ 400.00	R\$ 400.00	R\$ 400.00 to R\$ 1,000.00
Travel	US\$ 1,000 to US\$1,500		
Hotel- 4-3 star	US\$ 90.00 to US\$150 /day	US\$ 120.00 to US\$ 200.00	US\$ 200 to US\$ 300
Average time	5 days	5 days	9 days
Stand	US\$ 400/m2	n.a.	n.a.

**Source:** The Post Office. "Exporta 2005"

### Risks

Trade and investment with India and South Africa are widely perceived as high-risk propositions. Too many things are unknown, too many stereotypes prevail, too little market research has taken place. Among the risks mentioned, the following stood out in the interviews:

- Two firms mentioned security levels in South African cities as a problem, while acknowledging that those levels tend to be at similar in major Brazilian cities; there is no information regarding security levels in India;
- Two firms emphasized what they considered too much bureaucracy in India and South Africa, particularly at customs, product registration and legal documentation;
- Political instability was not mentioned in the context of South Africa but 3 firms said that India is situated in a delicate region, ridden with religious and political conflicts. Even natural disasters have been mentioned as a deterrent for India and its region. A fourth firm also pointed to health hazards in Indian cities;

- Economic instability was mentioned as a risk by 2 firms. For the most part, however, neither South Africa nor India are perceived as countries prone to economic turmoils. One firm did mention, however, its distrust regarding the respect of intellectual property rights, including counterfeiting.

The following statement is quoted from one of those interviewed as an illustration of the generalized perception on the part of Brazilian entrepreneurs of doing business with India and South Africa:

*"...but they are also markets with great structural and market-related difficulties, such as logistical costs, reliability of the institutional framework, payment capacity, hardly transparent rules."*

### **Facilities and Key Prospects**

Only 20% of those interviewed export to South Africa while only 10% do to India. Only one firm actually imports from India.

In spite of all the perceived and actual barriers, most of those interviewed could see the enormous potential of both South Africa and India. For 15% of the firms, the Indian market is very competitive and the beginning of operations in that market would be too difficult. For some 60% of the interviewed, there is no future interest in doing business with India. Among the reasons given as to optimism in trade and investment relations with India, the following should be mentioned: 1) big market; 2) relatively open market; 3) small Brazilian presence; 4) potential in some products such as fruit concentrates.

In the case of South Africa, the positive aspects mentioned are the following: 1) geographical proximity; 2) similar culture; 3) compatible business environment; 4) manageable transportation costs; 5) market potential; 6) contact "easiness". A generalized perception that applies to South Africa is that it is an important "hub" for a number of other African countries – clearly in its part of the African continent. There is a wide expectation that African markets can only expand and that Brazilian products and investment can have a high acceptance in them, including, in some cases, for cultural reasons, as is the case with neighboring Angola and Mozambique. Another widespread perception is that a new phase in Brazil-African relations is underway, now that the region is no longer plagued with civil wars.

There are areas often mentioned as potential areas of cooperation. The pharmaceutical sector, for example, should be a good candidate for integration and cooperation between India and Brazil, as inputs from India are very competitive and can be imported by Brazil while natural products from Brazil can also be of great interest to the Indian industry. As mentioned before, the software sector is also an important candidate for further India-Brazil cooperation.

In relation to South Africa, in addition to medical equipment and disease treatment, cooperation may also make sense in the automotive and transport material sector with a view to greater integration and optimization of production processes. As the two

markets have a great deal of similarity, there may be great room for common projects and an increased trade and investment outlook for auto parts and components.

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<sup>1</sup> The overall perception here is that Brazil has gone overboard "making all the concessions" in the Mercosul agreement with the Andean Community. As usual, perceptions normally reveal the truth at some important level.