

# **BRAZIL IN SOUTH AMERICA: INTERNATIONALIZATION OF THE ECONOMY, SELECTIVE AGREEMENTS AND THE HUB-AND-SPOKES STRATEGY\***

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## **ABSTRACT**

Over the past 20 years, the importance of South America for Brazilian strategic interests has increased dramatically. More recently, burgeoning Brazilian trade flows with South American countries have been accompanied by a surge in direct investment. This has occurred despite meager domestic political support for Brazilian participation in regional integration projects and cooperation structures. As a consequence, increased Brazilian economic presence in the region has taken place independently of official regional integration efforts. This article presents and discusses Brazil's agenda for the region, focusing on strategies formed in the light of regional agreements, Brazilian diplomatic activism in relation to South American, and recent expansion of Brazilian trade and investment activity in the region.

## **1 INTRODUCTION**

Since the early 1980s, Brazil's policies and presence in South America have changed dramatically. The main features of this change, on the one hand, have been the increasingly positive nature of the Brazilian regional agenda, in strong contrast to previous periods when countries of the region were considered of lesser importance or even as threats to Brazilian interests. On the other hand, there has been a tremendous increase in the intensity of Brazil's political and economic ties with countries of the region. Such ties were initially of trade but, more recently, have developed into Brazilian direct investment in these countries.

In the late 1990s, Brazil's regional diplomatic agenda gained clearer perspective and outlines. The rhetoric of regional integration and of a South-American framework received a boost with the inauguration of President Luis Inácio Lula da Silva, in the context of the new administration's ambition to raise the nation's international profile, previously perceived as being "unassertive in defending national interests and unassuming in definition of its goals."<sup>1</sup> Within this context, South America (in place of the traditional notion of Latin America) became a

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1. President Lula cited South America and Mercosul 8 times in his inaugural speech in 2003, thereby underscoring the importance of the theme for his plan of government.

priority and, upon this new basis, a number of integration and political coordination initiatives were prepared. As will be explained later in this text, the first effective efforts in this field concentrated on certain industrial areas, whereas later initiatives enjoyed only limited success. From an economic standpoint, it was in the 1990s that trade flows began to soar, and in the 2000s that Brazilian investment in the region<sup>2</sup> took off, both developments being only remotely linked to regional integration initiatives.

Some authors have identified distinct steps within the broader cycle of Brazilian regional activism but, generally, these are based upon developments within the scope of the Common Market of the South (Mercosul/Mercosur) rather than on the broader scope of relationships between Brazil and South America.<sup>3</sup> Be that as it may, all agree that they start with the laying down of the Mercosul framework, between 1991 and 1996-1997. During this phase, there was an attempt to combine the sub-regional integration process with economic reforms and trade liberalization. In the next phase, a more conflictive dynamic began to prevail within the block, stemming from external economic shocks and domestic emergency adjustment policies. At this point, agreements signed and partially implemented in the earlier phase began to crumble, especially those pledging commitment to free trade within the block and deployment of a Common External Tariff (CET). This phase is generally associated with the period from 1997-1998 up to 2002. Finally, the third phase (after 2002) was characterized by a resumption of economic growth in countries of the region, but also by a deepening of divergences among their economic strategies and a widening of economic, institutional and public-policy asymmetries between Brazil and other countries of the region. Although this division into periods is not a consensus in literature, main authors would agree with this description of the cycle.

These developments in the nation's regional agenda are related to assessments and perceptions of a portion of the Brazilian elite. According to Souza (2009) among the ten greatest international threats to Brazil, as perceived by the Brazilian political elite, six relate to global issues (global warming, trade protectionism on the part of the wealthy countries, proliferation of nuclear weapons, international terrorism, and economic inequality) whereas the other four were regional in nature (drug trafficking, authoritarian governments in South America, international meddling in the Amazon region, and arms smuggling).<sup>4</sup> Thus, though not regarded as the most important issues, regional themes are, nonethe-

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2. See Ribeiro and Lima (2008).

3. See, for example, the work of Pereira (2007) and Hoffmann, Coutinho and Kfuri (2008).

4. This survey used a sample of 400 people considered influential in policy formulation and decision making on international themes in Brazil, including diplomats, military officers, academics, journalists, and business and union leaders. The survey was carried out in 2001 and repeated in 2008.

less, always present. Also based upon this survey, defending democracy in South America, strengthening Brazil's regional leadership, and fostering infrastructure integration in the region were ranked as prime goals for Brazilian foreign policy. In other words, in recent years a reasonable consensus has been reached, among the group that accompany international themes in Brazil, on the strategic importance of South America for this country. There is little evidence, however, that this perception is shared by the rest of Brazilian society, nor that the dominant strategic vision favors political and economic integration.

Nonetheless, conversion of this perception of the strategic importance of South America (and of the need for greater economic interaction with neighboring countries) into a broader South-American policy is still somewhat dubious. Such dubiousness has been variously manifested, not only by weak political support for Brazilian engagement in a regional economic-integration and political-convergence project, but also through poor capacity on the part of the Brazilian Federal Government to implement programs and internalize decisions and agreements of regional forums. Thus, Brazil's regional strategy remains hardly in evidence, and most certainly fails to live up to the promises of upbeat diplomatic discourse. The truth is that the diplomatic dimension is just one of the relevant vectors of this process.

It would thus appear that (at the same time but with little coordination) in Brazil there is: a perception of the growing importance of South America for the nation's strategic interests; a positive trade and investment cycle with neighboring countries; and weak political support for Brazilian engagement in economic integration projects or regional political coordination mechanisms. One possible explanation for this phenomenon is that the prevailing sentiment in Brazil favors a form of regional relations based upon projection of Brazilian political and economic prowess, rather than on regional integration. This implies a pattern of regional relations based on a hub-and-spokes model (of the type employed when analyzing relations between the United States and countries of Latin-America, or even between the United States and countries of Asia) rather than the European model of regional integration manifested by relations of France and Germany with surrounding countries.<sup>5</sup> If, from the standpoint of regional political strategy, the hub-and-spokes model prevails, from an economic standpoint, growth of regional trade and investment is an outcome of internationalization of the Brazilian economy, for which countries of the region provide a privileged space for boosting business; but not as a consequence of deployment of a regional economic integration strategy.

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5. There is extensive literature on this theme, and particularly on trade issues. See Blyde (2004), Coe and Helpman (1995), Coe, Helpman and Hofmaister (1997), Schiffe Winters (2003), Das and Andriamananjara (2004) and Mindreau (2001). Minister of External Relations, Celso Amorim, made critical mention of the United States' posture in the region (Amorim, 2007).

According to this hypothesis, Brazil's actions in relation to South America are oriented by significant diplomatic activism (including engagement at the presidential level) but are conditioned by a preference for a weak institutional structure and low levels of engagement with regional policy bodies and frameworks. The outcome is that such arrangements are hardly effective, and may not even be applied domestically. Examples of themes in this category are tariff and non-tariff issues<sup>6</sup> (which tend to characterize the region by trade preferences, rather than as a free-trade area or as a customs union, in view of huge current tariff distortions<sup>7</sup>) and technical cooperation arrangements.

On the other hand, more robust agreements and projects in the region involving Brazil tend to take place on bilateral bases, *i.e.*, they are derived from Brazilian governmental and/or private decisions, enjoying support of Brazilian government agencies and negotiated with public and/or private players in the neighboring country. Typical cases in this field are: the Itaipu power plant and agreement; the Brazil-Bolivia energy agreement; the Brazil-Bolivia gas pipeline and Petrobras' investments in that country; the payments system using local currency between the Central Banks of Brazil and of Argentina; and infrastructure projects financed by the Brazilian Development Bank (BNDES) in countries of the region. Only a small group of agreements and programs are indeed regional and effective, with shared governance and operating mechanisms that substantially affect economic operations. Examples are the Fortaleza Agreement in the field of civil aviation, and the Mercosul Automobile Regime, among others.

Some authors, when discussing this theme, have suggested hypotheses as to the ranking of South America in Brazil's international strategy. Vigevani *et al.* (2008) who examined Brazilian foreign policy, affirms that:

two highly important concepts in foreign-policy formulation – namely, autonomy and universalism – are deeply rooted in society and in the State, and merge in the construction of a vision of regional insertion which hampers deepening of Mercosul.

Generally speaking, however, there have been no broader efforts toward coordination and convergence. This low level of Brazilian effort to further the regional integration program, according to Vigevani and Ramanzini Júnior (2009) is linked to a dilution of the initial impulse in favor of common development, although pursuit by each member of potential economic advantages persists. Lima (2006) suggests that the composition of the schools of thought (autonomists and prag-

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6. See the works of Kume and Piani (2005).

7. Approval, on August 3, 2010, of the Mercosul Common Customs Code, which provides the bases for elimination of double taxation on imported goods circulating among the member countries, if actually put into effect, may imply a change in the standard of effectiveness of Mercosul tariff rules.

matic institutionalists) is what provided the bases for the progress of the integration process in the early years, both of these groups being reticent with regard to the advance of regional commitments. Groups more favorable to institutional deepening of Mercosul (the progressists) briefly had the upper hand at the onset of the Lula Government (LIMA, 2006) however, their achievements were quite limited.<sup>8</sup>

According to Lima (2007) there is a weak domestic coalition in favor of the strategic alliance with Argentina, in relation to Mercosul and to Brazil's engagement with South America. In this researcher's view, after 20 years, this project has failed to produce sufficient integration policies. Taking a more pessimistic view in relation to Brazil's engagement in integration projects, Veiga and Rios (2008) having examined the most trade-intensive sectors within Mercosul (automobiles and chemicals) stated that:

the mantra of 'complementation among production chains' adopted by the Brazilian government as a strategy for enhancing intra-industry relations between the two countries failed to demonstrate any capacity to go beyond rhetoric, either for these, or for any other sectors of industry.<sup>9</sup>

In this manner, Brazil's enhanced economic presence in South America in recent years appears to have occurred independently of the advance of projects and agreements of an integrationist nature in the region. In other words, regionalization (*i.e.*, the increase in regional relations not derived from policies and agreements between States) appears to have advanced more rapidly and with greater depth than the official regional integration process coordinated and negotiated among the States.<sup>10</sup>

Based upon these premises, this article is divided into seven sections. The first discusses Brazil's strategy in the context of existing regional agreements; the second presents a profile of Brazil's regional agenda; the third characterizes South-American and Brazilian diplomatic activism; the fourth discusses recent increases in Brazilian trade and investment in the region; the fifth presents the South American Regional Infrastructure Integration Initiative (IIRSA) as an example of a project very much in line with Brazilian political preferences; and the sixth section pursues an argument similar to that of the fifth, but more specifically applied to the theme of energy. Finally, the seventh section seeks to draw some overall conclusions.

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8. For a less critical view of the goals of Brazilian integration with South America, see Amorim (2009) and Erthal and Magalhães (2007).

9. Other texts include discussions on this theme, among them Kume and Piani (2005), Vaz (2002), Veiga and Rios (2008), Veiga and Rios (2006).

10. On the concepts of regionalization, regional cooperation and regional integration, see the discussion in Bouzas (1999).

## 2 BRAZILIAN STRATEGY AND THE REGIONAL CONTEXT

The regional strategy predominant in Brazil, based on participation in shallow regional arrangements and effectively operating in line with the logic of a hub-and-spoke model, appears to be quite adequate, in view of the myriad trade policies of the South-American countries and of the various current regional economic arrangements. One remarkable characteristic of the South-American region is the overlap of innumerable regional agreements of thematic scope, with varying degrees of importance and different institutional and regional focuses. Agreements of a regional nature, such as the Latin American Integration Association (LAIA), the Latin American and Caribbean Economic System (SELA)<sup>11</sup> and the South American Regional Infrastructure Integration Initiative (IIRSA) stand alongside sub-regional arrangements such as Mercosul and the Andean Community of Nations (CAN), besides a number of bilateral agreements, foreseen either within the scope of the Latin American Integration Association (LAIA) (as is the case of the Economic Complementation Agreements -ACEs)<sup>12</sup> or outside this scope as, for example, agreements on themes such as energy, transport and telecommunications. Some countries of the region (for example, Guiana and Suriname) though not party to the more effective agreements, do participate in IIRSA. Though all of these agreements are inter-governmental, some have an institutional structure, with Secretariats-General that provide support to councils of ministers (as do LAIA and Mercosul)<sup>13</sup> whereas others (such as IIRSA) have no institutional structure and essentially consist of a forum for coordination of infrastructure projects. Some, like Mercosul<sup>14</sup>, have dispute-settlement mechanisms, whereas others rely entirely upon arbitration and mechanisms beyond the scope of the agreement. Some countries of the region apply very low tariffs, as is the case of Chile which, though an associate member of Mercosul, in 2009 had an average tariff of 1.1% and a tariff cap of 7%;<sup>15</sup> in contrast to the external tariff profile of Mercosul where the average is 14% and the cap 35%<sup>16</sup>. Unlike Europe, where various regional arrangements underwent different phases of accommodation and merging,<sup>17</sup> in South America such arrangements have continued to coexist and, at times, to compete with each other.

11. Created in 1975 by the Panama Convention, SELA has 27 member countries and seeks to coordinate economic strategies and promote integration among countries of the region.

12. ACEs are voluntary and successive bilateral agreements, among LAIA members to deepen trade through preferential trade agreements.

13. Created in 1991 as the Administrative Secretariat of Mercosul, but in 2002, it became a Technical Secretariat. The Protocol of Ouro Preto of 1994 transformed Mercosul into an international corporate entity.

14. Created by the Protocol of Olivos, signed in 2002, and went into force in 2004.

15. Bulletin of the Chamber of Commerce of Santiago, July 2009.

16. Bulletin of the National Confederation of Industry (CNI). *Unidade de Negociações Internacional*. 2009.

17. See Menezes and Penna (2005).

Problems have emerged within the scope of LAIA (the main regional trade framework agreement) when the group determined that its members should extend to regional partners tariff treatment similar to that granted to extra-regional partners. This issue came to the fore when Mexico signed the North American Free Trade Agreement (NAFTA) in 1994, thereby reducing its import tariffs for goods from the USA and Canada to zero. At the time Brazil protested, and even suggested that Mexico should leave LAIA. However, subsequently, other countries of the region launched free-trade negotiations with the USA and also with European and Asian countries. Chile and Peru succeeded in signing broader and deeper agreements (encompassing lower tariffs and such themes as trade in services and intellectual property) with countries outside the region than those maintained with countries of the region.<sup>18</sup>

Thus, throughout the region today, an overlapping web of agreements prevails, which, as a general rule, detracts from the benefits that a homogeneous common preferential South-American economic area could offer. From the Brazilian standpoint, this process has eroded trade-preference margins enjoyed in the region up until the mid-1990s but, at the same time, has not required that Brazil open up its markets to the same extent that its regional partners have. In other words, Brazil would rather lose its preference margins on access to these markets than relinquish its room for maneuver on trade and tariff issues.

Against this background, it is interesting to note that, from the economic standpoint, Brazil's official strategy has been to lead efforts to expand Mercosul<sup>19</sup> with a view to the incorporation of the Andean countries,<sup>20</sup> retaining original characteristics of the Common Market's inter-governmental structure, while maintaining a reasonable degree of flexibility in relation to agreements signed, through a low level of macro and microeconomic coordination and tariff levels very close to those applied domestically.<sup>21</sup> Brazil has not managed to establish trade negotiations with neighboring countries that are any more comprehensive than those that such countries have signed with third parties. This has weakened Brazil's leadership role in the regional economic integration project. Though it raises problems for the trade in goods, this is of particular

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18. The Chile-US Free-Trade Agreement was signed in 2003 and went into effect in 2004, and the Peru-US Agreement was signed in 2006 and went into effect in 2008. Chile has more than 40 free-trade agreements with European and Asian countries.

19. Though essentially an economic agreement, Mercosul also has a political dimension, as evidenced by approval of the Political Consultation Mechanism in the Presidential Declaration of the Democratic Commitment of Mercosul in 1996, the Ushuaia Protocol on Democratic Commitment in 1998, and establishment of the Mercosul Democracy Observatory (ODM) in 2007.

20. In 1996 Bolivia and Chile became associate members of Mercosul and, in 2004 under a framework agreement (Decision CMC N 18/04) Mercosul membership of the Andean countries brought in Venezuela, Colombia and Ecuador as associate members.

21. A similar argument was made by Vigevani *et al.* (2008).

significance for trade in services, a field on which Mercosul maintains agreements that are internally very shallow, and only one framework agreement with an associate-member country, Chile.

One of the difficulties for advancing Mercosul in the region is that the block's tariffs are higher than those of other countries of the region. This, for new member countries joining the block, implies adoption of higher tariffs than they currently practice. Even for Venezuela, which has average tariffs similar to those of Brazil, joining Mercosul implies raising tariffs on various industrial sectors.<sup>22</sup>

Nonetheless, Brazil has not relied on trade agreements to expand its exports substantially to these countries in recent years. A study by the National Confederation of Industry (CNI, 2007) shows that Brazilian exports to South America grew at a rate higher than growth of total exports between 1990 and 2006, the most significant increases being in sales to Argentina, Venezuela and Colombia, followed by Peru and Guiana. In this group, only in the case of Argentina can such growth be clearly associated with a project for economic integration with Brazil. On the other hand, the growth of the exports from countries outside the region to South-American countries has been even greater than the growth of Brazil's exports to the region. This growth of extra-regional exports may, even in the short term, significantly undermine Brazil's economic presence in the region, the main threat being from China.<sup>23</sup>

With respect to agreements in the political sphere, the situation is not unlike that which prevails in the economic and trade areas: a web of overlapping agreements, with diverse objectives, geographic scope and institutional arrangements which, in general, are of little practical relevance. Some agreements are of a bilateral nature,<sup>24</sup> others sub-regional,<sup>25</sup> and some agreements are continental,<sup>26</sup> Latin-American<sup>27</sup> and hemispheric<sup>28</sup> in scope. Amorim (2009, p. 21) referring specifically to regional agreements, states that it is not a strategy of "concentric circles", his preferred expression being "*3 levels of integration*". Such regional arrangements compete on various themes with other arrangements of a trans-regional nature, such as the India-Brazil-South Africa Initiative (IBSA), the Ibero-American Summits, the Arab South-American Summit, the Community of

22. See Coelho *et al* (2006).

23. See the ECLAC study (2010). Chinese exports to the region have grown by more than 26% p. a. over the past ten years, whereas Chinese imports from the region have increased by 22% p.a. over the same period.

24. Such as the Brazil-Argentina nuclear accord and the Brazil-Argentina Agency for Control and Accounting of Nuclear Materials.

25. Such as the afore-mentioned political agreements within the scope of Mercosul.

26. The Union of South-American Nations (UNASUL) is the prime example.

27. Such as the Community of Latin-American and Caribbean States, that arose from merging of the Group of Rio and the Latin America and Caribbean Summit (CALC), created in February 2010.

28. The main reference being the Organization of American States (OAS).

Portuguese Speaking Countries (CPLP) and the BRICs Summit,<sup>29</sup> among others. In both economic and trade terms, the level of engagement and commitment by Brazil in these arrangements is low, and is based upon summit meetings and an intense bilateral agenda. Although the very number of these initiatives suggests a degree of dispersion of interests, Brazilian political activities have combined certain non-regional strategies (such as the IBSA and BRICs Summits, or bilateral initiatives within Latin America)<sup>30</sup> with the effort to coordinate South-American political articulation. In the past decade, this effort has sought to transform the Summit of South American Heads of State (held in Brasilia under Brazil's leadership, in 2000) into a permanent intergovernmental political body, with a minimal institutional structure. The combination of these strategies has enabled Brazil to act, sometimes in an individual capacity with significant room for maneuver in pursuit of its own political objectives, and sometimes to lead collective regional actions through UNASUL.

Thus, in both the economic and political fields, Brazil has neither conditioned nor limited its strategies and interests in pursuit of its regional project. Its actions in the region are selective and lack institutional structure, and blend various initiatives of a bilateral and extra-regional nature. Therefore, the growing regional presence of Brazil over the past two decades (both in political and in economic fields) bears no direct causal relation with its regional integration project. Brazil's South-American integration projects are merely a part of its broader international strategy, mobilized according to the measure in which they may enable gains, without compromising the country's room for maneuver nor restricting its capacity for individual action.

The affirmation that Brazil's regional project does not comprise the central thrust of its international strategy in no way implies that Brazil lacks a positive regional agenda. Brazil, in recent years, has constructed an agenda of regional interests which (though selective and poorly mediated by institutions) is nonetheless important, especially for certain economic segments. The next section will present and discuss this positive agenda.

### 3 THE BRAZILIAN AGENDA FOR SOUTH AMERICA

As explained earlier, Brazil's posture vis-à-vis South America is the outcome of a retraction in relation to the heterogeneous and asymmetric context of the region and, at the same time, a strategic option, whereby the prevailing guideline favors low commitment with the region. In view of this context, any regional actions

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29. The first Brazil, China, India and Russia Summit was held in Russia in 2009. The second was held in 2010 in Brazil, and the third in 2011 in China.

30. Brazil's actions in Honduras and in Haiti are illustrative.

and programs in which Brazil becomes effectively involved (*i.e.*, those that go beyond general agreements and letters of intent) are made feasible only by means of political and institutional gaps. Such gaps are defined by spaces in which specific interests on regional themes do not conflict with the broader option of impeding the country's political and economic interests becoming subordinated to regional integration projects. Thus, any projects or programs that affect regional themes (and especially economic themes) can only be deployed by means of specific agreements, involving measures strictly within the scope of those Executive Branch agencies that are more attuned to regional themes, that do not require alteration in Brazilian public policies or regulatory standards and, more especially, that do not compromise national decision-making capacities. Generally speaking, such programs and projects can be implemented without involvement or approval of Brazil's National Congress.

In view of this style of action based on a selective agenda and political and institutional gaps, it is hardly surprising that in Brazil, the only regional themes that are ever contemplated are those which are, essentially: shallow from the standpoint of conditionalities; limited in scope; and predominantly bilateral. Current regional arrangements, or proposals during the course of this period, were often poorly structured or strongly diluted in relation to their original objectives. Some examples of this are the huge restrictions upon use of the Convention on Reciprocal Credits (CCR)<sup>31</sup> in regional trade contracts;<sup>32</sup> approval of the Mercosul Structural Convergence and Institutional Strengthening Fund (FOCEM)<sup>33</sup> "with minimum annual contributions"; and resistance of the Federal Revenue Service to implementation of various customs and tax procedures agreements. Measures that have prospered have enjoyed support of a strong coalition of interests and economic players, in articulation with Executive Branch agencies that have decision-making power on the theme (given that the Ministry of External Relations [Itamaraty] does not have the authority to bring into effect the regional agreements that it promotes). In general, such measures have involved the Ministry of Development, Industry and Foreign Trade (MDIC) or the Brazilian Development Bank (BNDES) and were not subject to vetoes or significant opposition from members of the Legislative Branch.

Consequently, over the past 15 years, the Brazilian regional agenda has molded itself not only to the complexities and oscillations of the South-American context, but also to limited domestic political spaces. The divergence of strategic views

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31. This is a multilateral credit system among the LAIA countries, operated by the respective central banks which requires the use of dollars and other convertible currencies.

32. See discussion of the document of the Secretariat of National Treasury (STN) and Secretariat of International Affairs of the Ministry of Finance (SAIN/MF) (BRAZIL 2005) on this theme and especially on the use of CCR.

33. FOCEM was created by CMC Decision 45/04 in 2006.

on South America on the part of the nation's politicized elite, and the extremely limited engagement of Executive and Legislative Branch agencies, has had a direct effect upon the way Brazil engages with more formal regional regimes and in negotiations. Thus, an agenda has been drawn up with a very particular profile under which the following characteristics are underscored: *i)* preference for arrangements with little institutional structure and based upon summit meetings, including the Mercosul summits; *ii)* projects based on the notion of "shallow economic integration", *i.e.*, focused upon trade issues to the detriment of themes relating to productive, financial and logistical integration; *iii)* shallow integration also with respect to commitment to microeconomic initiatives and policies targeted at industrial, research and development, and credit policies, etc.; *iv)* predominance of cooperation programs on themes such as customs, security, drug trafficking, social policies etc.; *v)* *ad hoc* initiatives in the fields of infrastructure and energy integration, in which bilateral approaches prevail over regional dynamics; *vi)* preference for the strengthening of domestic credit agencies (particularly the BNDES) in detriment to the creation of agencies of a regional nature; and *vii)* increasingly direct support of the government to private green-field direct investment initiatives or acquisitions of productive assets in the region, in detriment to the establishment of regional investment protection and promotion arrangements.

With respect to the preference for arrangements with little institutional structure and based upon summit meetings, including Mercosul itself, there has been a remarkable number of (bilateral, minilateral and regional) presidential meetings in South America, in stark contrast to the lack of a regional body with any degree of authority. Even the more institutionally structured arrangements, such as Mercosul and the Andean Community (CAN) are endowed only with executive secretariats and support staff. The Permanent Review Court [TPR] (approved in 2002) and the Mercosul Parliament (approved by CMC Decision 23/05, and to which representatives are to be elected directly by the population of member countries) represent attempts to endow this project with greater institutional structure, but are, in effect, very limited in scope. In Brazil, the most populous, economically robust, and politically and militarily powerful nation of the region, the theme of setting up supranational regional bodies tends not to rank very high among the interests of any politically relevant group.

Aligned to this Brazilian preference for arrangements with little or no institutional structure is a preference for a "shallow economic integration" model, focused primarily on agreements that reflect trade-preference patterns rather than economic integration. Such agreements have been more focused on negotiations relating to tariff barriers and rules of origin, rather than on harmonization of regulatory, technical, phytosanitary and other barriers. Since Mercosul itself is not yet a consolidated free-trade area but, rather, a partial customs union, the

agenda of the block remains bogged down with themes relating to automatic licenses, temporary tariff increases, etc. To move forward with deepening of existing trade agreements, and especially questions relating to non-tariff barriers and regulatory issues, has proven politically difficult. The main obstacle is reluctance on the part of various national agencies to reviewing or adjusting their standards in order to comply with agreements negotiated within the scope of Mercosul, thereby reflecting resistance to the internalizing of such agreements.<sup>34</sup>

Among the contentions raised by Mercosul partners are competitive asymmetries that favor Brazilian companies, especially those derived from support provided by bodies devoted to fostering production, credit, innovation and exports. Actions of such bodies as the Brazilian Exports and Investment Promotion Agency (Apex), BNDES, the Brazilian Innovation Agency (FINEP), Banco do Brasil, Petrobras and Eletrobrás, among others, are perceived as elements that distort competition within the block. Critics argue that there should be similar mechanisms at the regional level. This discussion, to some extent, came to the fore during creation of FOCEM, a fund that aims at promoting structural convergence and competitiveness, since Brazil is responsible for providing 70% of its funding and is, thus, the most important party to the agreement. For the present, such funding has amounted to R\$ 100 million per year; a paltry sum for fostering regional integration when compared, for example, to BNDES's annual disbursements of R\$ 150 billion<sup>35</sup> This disproportion between domestic development policies and regional projects provides one of the most eloquent demonstrations of the low intensity of Brazil's regional engagement.

Along the same line of argument, direct and indirect participation of public bodies and programs – not just BNDES, but also agencies such as the Export Finance Program (PROEX) and the Export Guarantee Fund (FGE),<sup>36</sup> or even state companies such as Petrobras, Eletrobrás and Correios – in investments, financing or acquisitions in countries of the region, also supports characterization of Brazil's economic projection as being more like the hub-and-spoke model than the integrationist model.

It is thus possible to identify an agenda of Brazilian regional interests that, far from being comprehensive and integrationist is, rather, selective, focused on preservation of domestic decision-making capacities and on maintenance of national development instruments, and that is essentially targeted at advancing Brazilian projects and interests.

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34. A study conducted by Eletrobrás in 2009 indicates that Brazil internalized only two of the 12 regional agreements to which it is a signatory (*Prospectiva Consultoria*, 2009).

35. The sum disbursed on June 31, 2010, accumulated over the previous 12 months. See *Boletim de Desempenho do BNDES* of June 31, 2010.

36. Both are encompassed and monitored by the Export Finance and Guarantee Committee (COFIG), created by Decree 4.993 in 2004.

This approach on the part of Brazil has intensified in recent years, in view of a political and economic scenario that has been highly favorable to a rapid increase of direct investment in countries of the region by Brazilian private and state companies. From a political standpoint, even without any significant new regional agreements, the Brazilian government's political contacts and negotiations with countries of the region have intensified, with direct engagement at the presidential level and involvement of top echelons of the government. From an economic standpoint, Brazil's performance in the 2000s, combined with appreciation of the *real*, has fostered advantageous conditions for Brazilian companies to redefine their regional business strategies and advance rapidly with investment projects and acquisitions of assets in neighboring countries, despite slow progress on the development of integrationist arrangements.

#### 4 REGIONAL DIPLOMATIC ACTIVISM: FROM ALCSA TO UNASUR

In the diplomatic sphere, since the mid-1990s, political arrangements have been pursued, based upon the idea of a convergence of interests among the countries of South America, in replacement of a hitherto more common reference to Latin America. During the Government of Itamar Franco, in 1994, then-Minister of External Relations, Celso Amorim, suggested the creation of the South-American Free Trade Area (ALCSA) perceived at the time as a reaction to the creation of NAFTA<sup>37</sup> (and, more specifically, to Mexico's accession thereto) and to negotiations for establishment of the Free Trade Area of the Americas (FTAA).<sup>38</sup> This proposal outlined a strategy of automatic and linear tariff reduction among countries of South America, over a ten-year period, with the aim of affecting 80% of tariffs, while respecting lists of sensitive goods.

This announcement, which had no practical consequences at the time, was perceived as a move on the part of Brazil to avoid isolation within South America, in view of trade negotiations that various countries of the region were pursuing with the USA, many of which were subsequently concluded.<sup>39</sup>

This proposal also caused some issues already under examination, not only in the Brazilian diplomatic establishment, but also within certain other areas of government and among the national political elite to come to the fore; namely, the idea that Brazilian strategic interests have become South American, and are linked to the quest for a space enjoying a certain autonomy in relation to interests of the United States and multilateral arrangements.

37. In Portuguese, *Tratado Norte-Americano de Livre Comércio*.

38. ALCA in Portuguese. This initiative had already been announced in September 1993, by President Itamar Franco at a meeting of the Group of Rio in Santiago, Chile. However, the official document of the Brazilian Government on the theme only began to circulate in February 1994 at a LAIA meeting.

39. See the interesting contemporary commentary in Intal/IDB (1994).

This, to some extent, entailed alignment of rhetorical and diplomatic strategy, endowed with conceptual geopolitical bases that hitherto had been more in evidence in military and security fields, where adoption of a South-American reference was already more consolidated.

Thenceforth, despite a lack of like-minded engagement on the part of other areas of the Brazilian Government, creation of a South-American political arrangement became a priority for the Brazilian diplomatic establishment, a goal that was finally accomplished, in 2000, with the holding of the Summit Meeting of South-American Heads of State. This was the first meeting of its kind in the history of the region.<sup>40</sup> From this summit a final declaration was issued – the Communiqué of Brasília – calling for greater integration between Mercosul and the Andean Community, though the main focus was upon themes such as strengthening democracy, and the struggle against poverty and drug trafficking. Also presented and discussed at this meeting was a proposal for the creation of the South American Regional Infrastructure Integration Initiative (IIRSA).<sup>41</sup> Since then, South-American Summits have taken place every two years.

The South American Summit and IIRSA, are both clear examples of Brazil's intention to lead the development of South-American integration, through definition of a regional political space that excludes not only the United States but also Mexico (another traditional political competitor within Latin America) (SANAHAUJA, 2010, p. 105).<sup>42</sup> On the other hand, the nature of these initiatives also points toward a model of regional interaction based upon summits and spaces for coordination, rather than on arrangements of an integrationist nature. These two characteristics, which were already features of Brazil's actions, became even more evident in the following years, despite Brazilian diplomatic efforts to the contrary.

IIRSA illustrates the finished product of this model. Conceived as a space for coordination of infrastructure initiatives with potential regional (or at least binational) impact, IIRSA provides a base for comprehensive mapping of potential interconnections, referred to as “axes of integration”. Based upon such mapping, governments negotiate and coordinate their priorities and seek ways of bringing projects into effect (Tavares, 2009). Though original, this initiative was intended to encompass both physical and regulatory aspects, in terms of actual progress achieved, such projects have been quite limited and have focused mainly on physical interconnections, especially highway transport. Little significant progress has been achieved with the regulatory dimension, which focuses on integration of

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40. Summit of South American Heads of State, held in Brasília in 2000.

41. See the full text of the Communiqué at <<http://vNjw.itamaraty.gov.br/sala-de-imprensa/notas-a-imprensa/2000/01/comunicado-de-brasilia>>.

42. Another relevant event in this context was accession of Suriname and Guiana to this regional arrangement.

supply and demand in markets for infrastructure services. Within the physical dimension, some projects have advanced when the countries involved have mobilized financial support, either from domestic agencies (especially the Brazilian BNDES) or from multilateral agencies such as the Andean Development Corporation (CAF), the Inter-American Development Bank (IDB) and the World Bank. In other words, IIRSA is a highly decentralized coordination initiative with a very limited institutional structure, the aim of which is to establish a space for coordination of infrastructure projects.<sup>43</sup>

With the changes in the political and economic context in the ensuing years, not only in Brazil but also in various countries of the region (acute crisis in Argentina, an attempted coup d'état in Venezuela, political unrest in Bolivia and the election of Evo Morales, among others) Brazil's regional diplomacy has faced a less favorable scenario for its strategy of slowly and gradually building up its political leadership. Nonetheless, in subsequent years Brazilian diplomatic policy would attempt to sustain a series of bold initiatives, despite resistance on the part of Colombia to participation in any regional arrangement that does not explicitly acknowledge its priority of combating the guerrillas of the Revolutionary Armed Forces of Colombia (FARC), competition from the Bolivarian Project of President Hugo Chávez, an assortment of domestic political crises in Ecuador and Bolivia, not to mention constant trade and diplomatic disputes with Argentina.

The dynamics of the South-American summits of the following years illustrate this process. Still under the impact of the Argentine crises (of 2001 and 2002) and of events in Venezuela in the aftermath of the attempted coup of 2002, the 2<sup>nd</sup> South-American Summit, held in Guayaquil in 2002, limited itself to reaffirming premises of the 1<sup>st</sup> Summit. With the inauguration of the government of President Lula in 2003, Brazil sought to resume its South-American diplomatic offensive and concentrated its efforts upon approving, at the 3<sup>rd</sup> Summit held in Cusco in 2004, the creation of the Community of South-American Nations (CASA). Its principal goals on this occasion were: physical integration and institutional integration, both within a 15-year timeframe.

At the following summit, in Cochabamba in 2006, there was a perceptible atmosphere of mistrust as to the feasibility of the regional integration project. In at least three of the presidential speeches (those of Alan García of Peru, Hugo Chávez of Venezuela and Tabaré Vázquez of Uruguay) the theme was brought up. In view of this atmosphere of pessimism in relation to South-American integration initiatives, perceived as political events rather than as spaces for concrete decision making, it became incumbent upon Brazil and upon President Lula to argue that

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43. For a summary of the characteristics and performance of ten years of IIRSA, see Araújo (2009).

a common regional project exists, and that it is under deployment.<sup>44</sup> Also at this summit, and with the aim of placating critics, it was decided that a committee of high officials and work groups should be established in such priority areas as infrastructure, energy and social policies, with a view to ensuring implementation of decisions made at the summit. Finally, two new South-American summits were scheduled: one for 2007, with a focus upon energy integration; and another in 2008, in Cartagena, Colombia, that was subsequently transferred to Brasília.

At the 2007 Summit, held at Isla Margarita in Venezuela, Brazil followed a strategy of leading negotiations for establishment of a South-American political forum, despite the prevailing lack of enthusiasm for integration projects. To this end, Brazilian diplomacy submitted a proposal for creation of the Union of South-American Nations (UNASUR). Despite the delicacy of the processes by which political support was enlisted within Brazilian political institutions and among those of countries of the region, UNASUR was created with twenty-one very bold objectives, ranging from eradication of illiteracy to financial integration.<sup>45</sup> Along the same lines, also proposed by Brazil in December 2008, a decision was taken to create a Defense Council and new work groups, despite skepticism both in Brazil and abroad as to the political feasibility and relevance of such a body, and explicit resistance from Colombia to the proposal.<sup>46</sup>

Thus, notwithstanding a lack of strong support and enthusiasm on the part of other countries of the region, Brazil has maintained a considerable degree of diplomatic activism and has successfully approved its proposals for creation of a South-American political framework.<sup>47</sup> It is worth noting that the recently-created and polemic Defense Council proved useful during mediation of the Bolivian political crisis in 2009, and was the framework through which countries of the region, including Brazil, managed to exert influence in favor of a negotiated and peaceful solution to the crisis.<sup>48</sup> UNASUR has played a role in settling other political and security crises in the region, such as the crisis between Colombia and Ecuador in 2008, when the former attacked alleged FARC operational bases, and also when Colombia complained at the Organization of American States (OAS) that the Venezuelan government was maintaining relations with and providing support for the FARC. This illustrates how Brazil's objective of extending its in-

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44. See the article broadcast by BBC-Brazil, on December 10, 2006, citing passages from these speeches.

45. UNASUR comprises the Council of Heads of State and of Government, Council of Ministers of External Relations, Council of Delegates and a General Secretariat. Approved in 2007, the treaty was finally signed in 2008. Full text of the Constituent Treaty available at: <[http://www.nj.pptunasur.com/downloads/tratado-constitutivo-U\\_NASUR.pdf](http://www.nj.pptunasur.com/downloads/tratado-constitutivo-U_NASUR.pdf)>.

46. This debate was widely reported. See, for example, *Jornal Folha de São Paulo*. *Falta de consenso impede a criação do Conselho de Defesa* [Lack of consensus blocks creation of the Defense Council] (24/05/2008) and *Jornal Valor Econômico*. *Organização regional já nasce marcada por atritos* [Birth of regional organization marred by conflict] (23/05/2008).

47. For an examination of the South-American process from a Brazilian government perspective, see for example, Biato (2010).

48. See the article: *Lula takes the reins of the Bolivian crisis, says El País*. In: BBC-Brazil. 16/09/2008.

fluence and capacity for action in South America has advanced in recent years, and how UNASUR has, in an incipient manner, fulfilled its role.

In parallel to these Brazilian efforts, President Hugo Chávez has kept up an initiative which, to some degree, challenges the bases and objectives of UNASUR, in what the Venezuelan leader calls a “conservative initiative”, since it rests upon pre-existing conservative institutions such as Mercosul and CAN. The Bolivarian Alliance of the Peoples of the Americas (ALBA), announced in 2001 at the Summit of the Association of Caribbean Countries, the first meeting of which, with participation limited to Venezuela and Cuba, took place only in 2004. In subsequent years ALBA was expanded with the accession of Bolivia in 2006; of Nicaragua (2007); of the Dominican Republic and Honduras (2008); and of Ecuador (2009). Its broad agenda of development, social-integration, economic, technological, energy, and other themes was promoted alongside oil supply agreements between Venezuela and these countries (Altmann, 2007).

This initiative never represented a real political alternative to Brazil’s regional project and agenda. Venezuela’s lack of tradition as a regional political player, the weakness of Hugo Chávez’s government, and the low degree of economic complementarity among countries of this grouping have weighed against its consolidation as an effective block. Nonetheless, from the standpoint of Brazilian regional diplomatic policy, this initiative represents noise, as it has proven capable not only of attracting regional political interest and drawing attention to events to which Brazil is not party, but also because it uses as bases economic and trade relationships that differ distinctly from Brazilian proposals for the region.<sup>49</sup>

Difficulties of another type arose during discussions on creation of *Banco do Sul* [Bank of the South]. The initial proposal, from Presidents Hugo Chávez, Néstor Kirchner, Evo Morales and Rafael Correa, was for the creation of a bank that combined the functions of development, management of foreign reserves and regional central bank, and that would be capable of providing support for central banks in the event of foreign-exchange crises, and - at a later time - issuing a regional currency. Prior to engaging in this process, Brazil demanded that negotiations go back to the starting point, and managed to secure an agreement from the partners that the bank would be based on the model of a development bank, as it were, a “regional BNDES”. Under the model finally approved by the presidents, Banco do Sul would be launched with limited capital, some US\$ 7 billion, of which the Brazilian contribution was to be US\$ 2 billion, with similar

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49. The diametrically opposed postures of Brazil and of Venezuela in face of the Argentine economic crisis and default, in which Brazil distanced itself politically whereas Venezuela offered help, buying up more than US\$ 3 billion in foreign-debt securities at the time when Argentina was excluded from the international financial market, did not go unnoticed by the media nor by countries of the region. See, for example, repercussions in the *Jornal Folha de São Paulo: Venezuela pode comprar títulos da dívida do Equador* [Venezuela may purchase Ecuadorian debt papers] 22/02/2007.

sums contributed by Argentina and Venezuela. Moreover, Brazil did not commit itself to any schedule for this contribution, signaling that it might not be effected in the short or medium term. During this same period, Brazil made a US\$ 10 billion contribution to the IMF, thus exposing the low level of its interest in the formation of the new bank.

In the same context, the negotiations for reform of the Andean Development Corporation (CAF) were seized upon by Brazil as the most convenient means for establishment of a regional financial agency. Brazil managed to change the focus of these negotiations, by supporting the idea of transforming the CAF into the principal development institution of the region, thereby sidelining discussions on creation of Banco do Sul. Widely acknowledged for its professional and efficient management of financial projects in the region, the CAF is relatively exempt from domestic political intervention, and is considered a low-risk institution by the market (with a triple A rating). Brazilian participation in the CAF, which had amounted to US\$ 185 million (R\$ 325.4 million) is due to rise to US\$ 467 million (R\$ 821.4 million) by 2010.<sup>50</sup>

Alongside Brazil's financial strategy of upsetting negotiations on founding of the Banco do Sul and its assertiveness in relation to reform of the CAF, there were attempts on the part of certain governmental groups to strengthen traditional development and regional-integration institutions. Examples of such attempts include the attempt to expand the use of the CCR within the scope of the LAIA, which met with resistance from the Central Bank and the National Treasury Secretariat; creation of FOCEM in 2006; and restructuring of the Fund for Development of the River Plate Basin (Fonplata).<sup>51</sup>

These initiatives, however, have not altered the cautious posture in relation to initiatives in the region, and have left to the BNDES provision of direct assistance to companies and development of trade-support instruments.

In summary, interest on the part of one portion of the Government (namely, the diplomatic establishment) and of the political and economic elite notwithstanding, Brazil's capacity to bring its regional projects into effect has proven quite limited. Brazil's great diplomatic activism in recent years has produced a dynamic integrationist environment. Meeting resistance from within its own public administration and faced with an environment of growing regional instability and lack of political coordination, Brazil has sought to limit the advance of integrationist projects.

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50. See the minutes of the CAF Extraordinary Meeting of 08/12/2009, during which it was decided that Brazil would become a "special member" (Oliveira, 2009).

51. The two funds had very limited resources. Capitalization of FOCEM amounts to US\$ 100 million, whereas FONPLATA amounts to US\$ 160 million. As a basis for comparison, BNDES handles over US\$ 80 billion in loans each year.

## 5 REGIONAL TRADE AND INVESTMENTS

Trade provides an interesting perspective for assessing the advances and limits of Brazil's strategies for a South-American framework. From this perspective, also, there has been considerable Brazilian activism. However, at the same time, a series of problems stemming from asymmetries both of trade policies and of industrial and credit policies have come to the fore.<sup>52</sup> Since the 1980s, Brazilian exports to South and Latin America have steadily increased. Today, these amount to some US\$ 28 billion. Following a peak in regional trade, in 1999, the Argentine crisis of 2000-2002 led to a setback, but trade flows continued to grow in the following years (table 1).

TABLE 1  
Brazilian exports by region  
(In %)

	2001	2004	2007	2008	2009
South America <sup>1</sup>	6.4	6.6	9.1	8.4	8.2
Mercosul	2.4	8.6	10.5	11.0	10.3
European Union	7.2	25.6	23.9	23.4	22.2
China	2.6	5.9	6.4	8.3	13.2
Mexico	3.2	3.9	2.9	2.2	1.7
United States	4.2	21.7	16.6	13.9	10.2
India	0.4	0.7	0.6	0.6	2.2
Japan	3.9	3.0	2.8	3.1	2.8
Russia	1.3	1.9	2.4	2.4	1.9
South Africa	0.6	1.0	1.1	0.9	0.8
Others	17.6	21.1	23.6	26.0	26.4
<b>Total in R\$ (millions)</b>	<b>56,703</b>	<b>84,941</b>	<b>149,228</b>	<b>197,942</b>	<b>152,995</b>

Source: Ribeiro and Lima (2008).

NB: <sup>1</sup> Excluding Mercosul.

From the standpoint of regional economic relations, it can be stated that South America fulfills a strategic role for Brazil for at least three reasons. Firstly, the region has accounted for almost 20% of Brazilian exports in recent years. Secondly, Brazil has run up significant surpluses with countries of the region.<sup>53</sup> According to Souza, Oliveira and Gonçalves (2010, p. 23) rather than Brazil serving as buyer of last resort for the smaller countries of the region, the relationship has reversed, and they have become the buyer of last resort for goods from Brazil. Though hardly politically sustainable, this situation reflects the reasonable margin of trade preference and/or of competitiveness which Brazil still enjoys in

52. See discussions on asymmetries and Mercosul integration policy in Souza, Oliveira and Gonçalves (2010).

53. Brazil had a positive trade balance with Argentina, Paraguay and Uruguay, between 2004 and 2008, of approximately US\$ 22 billion.

relation to neighboring countries. Thirdly, the profile of Brazilian exports to the region, with a strong concentration of industrialized products (roughly 95%) is significant. In other words, the region is particularly important as an importer for Brazil's medium-technology industrial sector.

Another striking characteristic of Brazil's trade with South America is its sectoral composition. Agricultural and livestock exports are very small, whereas those of high technology goods are quite significant. For some sectors, more than two-thirds of exports of high value-added industrial goods are exported to these markets. This is true of electronic equipment, and especially products of the automobile, chemical, machine, electrical and electronic equipment sectors (table 2).

TABLE 2  
Brazilian exports. Total and to South America – by sector (2008)

Sector of activity/product	Brazilian total		Destination South America		South America
	Value	Share (%)	Value	Share (%)	Total (%)
Automotive industry	15,572	12.2	6,250	26.1	40.1
Chemicals and petrochemicals	11,768	9.2	3,347	14.0	28.4
Steel and metallurgy	14,949	11.7	2,433	10.2	16.3
Electronic equipment	3,797	3.0	2,259	9.4	59.5
Machines and equipment	5,492	4.3	1,743	7.3	31.7
Crude oil	5,529	4.3	1,076	4.5	19.5
Electrical material	3,244	2.5	1,020	4.3	31.5
Textiles	1,869	1.5	710	3.0	38.0
Pulp, paper and printed matter	3,764	2.9	693	2.9	18.4
Iron ore	8,123	6.4	341	1.4	4.2
Footwear	1,965	1.5	283	1.2	14.4
Subtotal	76,072	59.5	20,157	84.3	26.5
Other products	51,817	40.5	3,754	15.7	7.2
<b>Brazilian Total</b>	<b>127,889</b>	<b>100.0</b>	<b>23,911</b>	<b>100.0</b>	<b>18.7</b>

Source: Ribeiro and Lima (2008).

Both Benavente (2001) and Ocampo (2001) argue that the growth of intraregional trade in manufactured goods in Latin America during the 1990s was related, on the one hand, to market-access advantages deriving from integration agreements and, on the other, from a lack of third-party competition in markets for these products. In support of this argument, these authors indicate a dichotomic trend in the international trade of countries of the region, whereby such countries tend to direct their exports of manufactured products to the region, whereas they ship commodities and low value-added goods to extra-regional markets.

This pattern, to a certain degree associated with trade-preference margins granted under LAIA and Mercosul agreements, changed in the 2000s. These margins were progressively corroded during the 1990, owing both to a process of unilateral trade opening on the part of some of the major countries of the region and as a consequence of various free-trade agreements signed with countries outside the region. Chile (that has more than 35 free-trade agreements in effect, including one with China) and Mexico are the most outstanding examples of this development. More recently, Peru and Colombia have adopted similar strategies, both having signed agreements with the United States and with other countries.

Brazil (and to a lesser extent, Argentina) is the country that most strongly reflects this trade pattern. Nonetheless, as table 2 shows, the regional thrust of exports of medium-level technology manufactures has become concentrated in certain sectors.<sup>54</sup>

The services sector is quite different to the industrial sector, but nonetheless equally interesting and strategic for Brazil's penetration in the region. Over the past 20 years, the services sector has become consolidated as the most dynamic segment of international trade and, possibly, the one in which the main trade issues of subsequent decades will be concentrated.<sup>55</sup>

The Protocol of Montevideo (negotiated within the scope of Mercosul and focused on services) was signed in 1994 but only went into effect ten years later, in 2005. However, out of five lists negotiated, only the first is currently beginning to be deployed.

Brazil has various examples of excellence in the fields of services and technology. Engineering and construction are the only services sectors that show a surplus in its balance of payments. Information technology (IT) and business process outsourcing (BPO) services (fields in which India has had outstanding international participation) provide other examples of areas in which Brazil has demonstrated great capacity to compete and is currently increasing its exports and international participation. In some software-development areas, such as voice command and mobile-phone applications, Brazilian companies are at the forefront. A major portion of the mobile phones that Brazil exports (the recent export boom from Manaus has amounted to some US\$ 2 billion) contain on-board technology services, even though they are accounted for as goods.

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54. The case of the pharmaceutical industry provides a good illustration for this argument. Roughly 80% of Brazilian exports of this sector are to Latin America. Although there had been some reduction of regional tariff preference margins over the 1990s and 2000s, Brazil has managed to maintain a reasonable presence in these markets, especially in those where preferences predate unilateral opening in these countries or where the preference margin has been maintained, especially in the countries of Mercosul. See Barbosa, Mendes and Sennes (2006).

55. See Sennes, Valls and Mulner (2010).

South America is considered strategic for Brazilian infrastructure sectors. Its geographical proximity tends to facilitate operations in logistical terms and for shipment of machines, equipment and materials. Knowledge, on the part of Brazilian companies, of the specificities of markets and of the political realities of these countries, makes operations in the region easy in comparison to those in other parts of the world. Moreover, Brazilian construction companies are comfortable dealing with political risk in the region, a feeling not shared by their European and North-American counterparts.

Evidence of the importance of South America for Brazilian construction companies is to be found in the contribution of South-American activities to their overall billings. Their international activities correspond to no less than 30% of total billings, and in some cases as much as 75% of total corporate billings. Such foreign earnings are rising and practically all stem from activities in the region.<sup>56</sup>

Another significant aspect of Brazil's regional presence is direct Brazilian investments. Only in 2001 did the Brazilian Central Bank begin to keep accounts of production by Brazilian companies outside Brazil (measured by the stock of Brazilian direct investment - BDI). In that year, the stock of BDI amounted to just over US\$ 50 billion whereas, by 2006, it had risen to US\$ 114 billion, an increase of 129.7%. In this process, countries of the region are in the foremost position. Table 3 provides parameters on the intensity of Brazilian direct investment in the region.

TABLE 3  
Direct Foreign Investment: Brazilian investment projects in countries of South America (2007 to 2009)

Quarter	Number of projects – carried out		
	2007	2008	2009
1 <sup>st</sup>	5	6	4
2 <sup>nd</sup>	8	9	2
3 <sup>rd</sup>	10	3	3
4 <sup>th</sup>	10	10	3
Not available.	2	1	-
<b>Overall Total</b>	<b>35</b>	<b>29</b>	<b>12</b>

Source: IndexInvest Brasil, produced by CINDES. Available at: <[http://www.cindesbrazil.org/site2OIO/index.php?option=com\\_content&view=article&id=11&Itemid=16](http://www.cindesbrazil.org/site2OIO/index.php?option=com_content&view=article&id=11&Itemid=16)>.

On the list of the largest Brazilian multinationals, the holding of assets in countries of South America is a constant and, in most cases, a dominant factor. Even with companies that have a truly global profile, such as Vale, presence in

56. See *Prospectiva Consultoria* (2008).

the region is significant. In 2007, this group of companies held US\$ 56 billion in investments outside Brazil and was present in four countries of the region.

Acquisition of the South-American operations of BankBoston, in Argentina, Chile and Uruguay, by *Banco Itaú* (which already had an association agreement with *Banco Buenos Aires* in Argentina) reinforces the Brazilian presence in a hitherto under-exploited area. Brazil's public banks – *Banco do Brasil* and *Caixa Econômica Federal* – have also indicated interest in following this path and, in 2008, BNDES opened branches in Montevideo.

TABLE 4  
Principal Brazilian multinationals operating in South America

Company	Sector	Region	Countries
Gerdau (14 countries)	Steel	America Latina North America Europe Asia	Argentina, Chile, Colombia, Uruguay, Peru, Venezuela, Dominican Republic, Guatemala, Mexico, United States, Canada, Spain, India
Vale (26 countries)	Mining	Latin America North America Africa Europe Asia Oceania	Argentina, Chile, Peru, Colombia United States, Canada South Africa, Angola, Mozambique, Guinea France, Wales, Switzerland, Germany, England, Norway India, Oman, Mongolia, China, Singapore, Indonesia, South Korea, Japan Australia, New Caledonia
Petrobras (26 countries)	Energy	America Latina North America Africa Asia Europe	Argentina, Uruguay, Paraguay, Chile, Peru, Bolivia, Ecuador, Colombia, Venezuela, Mexico United States Angola, Libya, Mozambique, Nigeria, Senegal, Tanzania China, Singapore, India, Iran, Japan, Pakistan Portugal, United Kingdom, Turkey
Votorantim (14 countries)	Various	Latin America North America Europe Asia Oceania	Argentina, Bolivia, Peru, Colombia, Bahamas United States, Canada England, Belgium, Germany, Switzerland China, Singapore Australia
Camargo Corrêa (13 countries)	Various	America Latina North America Africa Europe	Argentina, Bolivia, Peru, Colombia, Venezuela, Paraguay, Chile, Uruguay, Mexico United States Angola, Morocco Spain
JBS (14 countries)	Meat packing	Latin America North America Africa Europe Asia Oceania	Argentina, Chile, México United States England, Italy, Switzerland Egypt China, Hong Kong, South Korea, Taiwan, Japan Australia

Source: IndexInvest Brazil, produced by Cindes. Available at: <[http://www.cindesbrazil.org/site2010/index.php?option=com\\_content&view=article&id=11&Itemid=16](http://www.cindesbrazil.org/site2010/index.php?option=com_content&view=article&id=11&Itemid=16)>.

The international expansion of companies from developing countries faces challenges because they tend to be less competitive than their rivals in the developed world. Thus, joint action on the part of the State and the company, through public policies of support and a proactive foreign policy, tend to be essential for reducing such difficulties.

This is an area in which Brazil has little tradition, in part, because the process of internationalization of its companies (as a general and consolidated phenomenon) is very recent. Nonetheless, Brazil has policy and institutional capacities in various areas that could be harnessed with a view to proactively fostering international participation of Brazilian multinationals. In this regard, the South-American economic space gains notable importance.

## 6 THE IIRSA PROJECT

The South American Regional Infrastructure Integration Initiative (IIRSA), launched at the 1<sup>st</sup> meeting of presidents of South America in 2000, has a mandate to foster physical union of the continent through infrastructure projects in the fields of transport, energy and communications. To this end, its specific objectives are to enhance bilateral trade by stimulating development in border regions, provide support for consolidation of production chains with a view to fostering competitiveness in greater overseas markets and reducing the “South-America cost” by means of creation of an articulated logistical platform.

Twelve South-American governments participate in the initiative, with technical support from three multilateral international organizations responsible for mobilizing funding: the IDB, CAF and FONPLATA.

In recent years, a portfolio of more than 335 projects has accumulated under this initiative, distributed into 40 groups, amounting to an estimated total of US\$ 37 billion. Actions under the initiative are guided by ten integration and development axes, defined in accordance with current flows and potential economic concentration. Another aim of the initiative is clearing regulatory, operational and institutional bottlenecks that hamper effective physical integration.<sup>57</sup>

From a Brazilian perspective, measures to implement integration of physical infrastructure have been underway since the first Multi-Year Plan (*Plano Plurianual* – PPP) of the Fernando Henrique Cardoso Government and were maintained under the Government of Luiz Inácio Lula da Silva. Having assumed the role of regional leader in deployment of IIRSA, Brazil now faces the task of harmonizing its interests in promoting future physical integration with those

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57. See the IIRSA Project Portfolio Documents available at: <[http://Awiv.iirsa.org/BancoConocimiento/B/bdp\\_resumen\\_cartera\\_por\\_sector/bdp\\_resumen\\_cartera\\_por\\_sector.asp?Cod Idioma=ESP](http://Awiv.iirsa.org/BancoConocimiento/B/bdp_resumen_cartera_por_sector/bdp_resumen_cartera_por_sector.asp?Cod Idioma=ESP)>.

of economic development in the region. Brazilian interest in promoting IIRSA has been explicit; indeed, aside from the involvement of the three international financial institutions, the BNDES has become increasingly involved in financing integrationist projects.

Out of the forty-nine groups of projects currently underway, Brazil is directly involved in ten, and indirectly in some additional nine. These projects are concentrated in the fields of highway and waterway transport on the Guiana Shield Axis, with highway links connecting Venezuela and Brazil. In the field of energy, there is a project to promote interconnection between the Brazilian and Venezuelan transmission networks, with a foreseen budget of US\$ 210 million. Integration routes in Rondônia, on the Mercosul-Chile Axis, and on the Paraguay-Paraná Waterway Axis are also the focus of transport investments, in both northern and southern portions of Brazil.<sup>58</sup>

Another significant factor in this program is the high degree of private participation, particularly in terms of funding sources, assuming of risk, and management at various stages. Unlike other regional integration projects, IIRSA has attracted a broad array of support, both in countries of the region and beyond, and has been endorsed by the World Bank and the cooperation agencies of developed countries. Once again, participation of private Brazilian companies in these projects has been quite significant.

Nonetheless, despite this impressive trend toward political convergence and pursuit of common bases for (and setting of) common planning priorities, there has been little implementation of such projects. Of the infrastructure themes, energy convergence is perhaps the one that has advanced most in recent years, paralysis and crises in the field of trade agreements notwithstanding.

## 7 ENERGY MATRIX

In the field of energy, much progress was made on the sub-continent, especially during the 1990s, when most countries of the region underwent reform and unbundling of their energy industries. In the 2000s, with few exceptions, this process stagnated.

Reassertion of the position of States and of their role as definers of policy; the creation of agencies that are independent of government and of state companies; new tariff structures based on marginal costs and long-term investment and without subsidies; unbundling of the production chain; increased private-sector participation; and formation of consortia to complement technological com-

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58. See the IIRSA Project Portfolio Documents at: <[http://Awiv.iirsa.org/BancoConocimiento/B/bdp\\_resumen\\_cartera\\_por\\_setor/bdp\\_resumen\\_cartera\\_por\\_sector.asp?Cod Idioma=ESP](http://Awiv.iirsa.org/BancoConocimiento/B/bdp_resumen_cartera_por_setor/bdp_resumen_cartera_por_sector.asp?Cod Idioma=ESP)>.

petencies, have opened up space for various energy-integration projects among countries. Nonetheless, the change in these patterns in the 2000s was accompanied by loss of dynamism of such programs.

The project for building an energy ring, agreed in August 2005 at the Mercosul summit in Asunción, was the first region-wide initiative for supply of gas, amid a number of binational initiatives. Though an important political landmark, the project has faced serious problems of implementation. It foresees expansion of the gas-pipeline network, with a view to supplying Argentina, Chile, Brazil and Uruguay with natural gas from Camisea in Peru. With an initial cost estimate of US\$ 2 billion, including construction of a 1,200 kilometer gas pipeline linking Pisco in Peru to the Tocopilla region of Chile. The project also entails complementing the Argentine pipeline network and construction of 500 kilometers of gas pipeline between the towns of Uruguaiana and Porto Alegre in Brazil. This would enable shipping of approximately 30 million cubic meters per day (m<sup>3</sup>/day) of Peruvian natural gas to other countries. Attempts to promote institutional improvements have been given space at Mercosul meetings and at UNASUR summits; progress, however, has been limited. In a context in which advancing with regional integration initiatives has become increasingly difficult, Brazil has achieved a degree of progress through bilateral and *ad hoc* agreements.

The feasibility of GASBOL (the Brazil-Bolivia gas pipeline) was largely dependent upon the initiative and support of the Brazilian State. The gas pipeline extends 3,150 kilometers, of which 2,593 are within Brazil; it begins at the Bolivian town of Santa Cruz de la Sierra and ends at Porto Alegre. Public investment includes participation of Eletrobrás, Petrobras, and the BNDES which is the main source of funding for the project. GASBOL, like the seven gas pipelines linking Argentina with Chile and the one between Argentina and Uruguay, represent initial steps toward regional integration, and presage greater energy interdependence among South-American countries. Nonetheless, in recent years, for a number of reasons ranging from political difficulties (nationalization) to management and regulatory problems, practically all of these projects have had to be redesigned.

Diversification of the energy mix, especially since the 2001 energy crisis, has been one of the Brazilian government's objectives. In view of the abundance of natural gas on the South-American continent, the Government plans to increase the share of gas in the national energy mix to above its current level of 10.2%. The role Petrobras has assumed is worth noting. Brazil's state oil company has branches in 15 countries and expansion of the gas pipeline network is among its goals. An agreement signed with Venezuela's State oil company (PDVSA) foresees

exploration of an oil deposit in Venezuela and refining at a plant in Pernambuco. However, after several years and various investment announcements, very little progress has been made.

In the oil sector, Brazil's main partner is Argentina. Since the early days of negotiating Mercosul, oil is a theme that has permeated trade relations between the two countries and, initially, led to an increase in Brazilian imports of oil from Argentina. Petrobras has been in Argentina since 1993, in the oil, gas (exploration, refining and distribution) and electric-power sectors, and has made a number of acquisitions. In January 2005, it merged all its holdings under the name Petrobras Energia S.A., thereby incorporating Eg3, Petrobras Argentina S.A. and Petrolera Santa Fé. Petrobras' production facilities and oil and gas reserves in Argentina are its largest anywhere outside Brazil. In Bolivia, Petrobras had been present since 1995, but it sold assets after nationalization by the Government of Evo Morales in 2006. Nonetheless, Petrobras still operates the Brazilian section of the gas pipeline and continues to import the quantities foreseen in the original contract, but now under a partial price adjustment.

Petrobras also maintains a small presence in Colombia. After making an initial investment in 1972, it withdrew from the country, but returned in 1986, basically in the field of exploration. It strengthened its presence in the 1990s and, in 2004, signed a large-scale exploration contract in partnership with Exxon and Ecopetrol, the Colombian State oil company.

Petrobras' strong and growing presence in these countries, for a number of reasons, has been the object of manifestations of political hostility. In Bolivia, nationalization of Petrobras assets took place with strong popular support. In Argentina, political skirmishing has also emerged in relation to the company's activities, and has resulted in restrictions being placed upon new initiatives of the company in that country.

As stated earlier, a significant portion of initiatives in the field of energy integration have occurred on a predominantly binational basis, rather than according to the rationale of regional articulation. This is especially evident in the field of electric-power transmission. Against this background, Brazil has achieved bilateral progress based essentially upon activities of its State companies and bank financing. Also evident is the Brazilian preference for arrangements with little institutional structure and based on summit meetings or general agreements, with strong participation of State companies. Although such initiatives (even those that are essential binational) are increasingly convergent, they contribute toward consolidation of a regional energy matrix without constituting any comprehensive institutional program.

## 8 SOME CONCLUSIONS

The trend toward emergence of South America as a focus for Brazil's regional activities has become consolidated. However, the country's capacity and interest in leading and sustaining initiatives targeted at achieving economic and political integration in the region, and the means whereby it intends to fulfill this project, remain open to discussion, in view of a lack of consensus on the part of the Brazilian political elite, asymmetric levels of engagement of the various federal government agencies, and disinterest of the Legislative Branch in this theme.

Brazil has been one of the most – if not the most – important of the regional political players. Thus, a major portion of the current configuration of South-American arrangements reflects its preferences and strategy. In other words, the predominance of Brazilian interests and presence in the region is, to a great extent, reflected by: a characteristic web of agreements with different densities and scope; the effort to extend such arrangements to a South-American space, rather than seeking to deepen existing agreements; weak institutional structure; low levels of microeconomic convergence; weakness of instruments to correct asymmetries; and a predominance of bilateral arrangements for energy and infrastructure issues.

In recent years, the growth of Brazil's economic relations within this space, as a major source of direct investment and as an exporter, has brought about a qualitative change in the country's regional presence. Notwithstanding advances in political and diplomatic action, and the timid and incipient processes of energy integration and coordination of the transport network, certain themes remain unresolved in relation to: growing asymmetries in economic and public-policy fields; the crisis facing traditional trade arrangements; institutional weaknesses of existing arrangements; and growing direct participation of Brazilian State agencies in the fields of development, credit and production.

Brazil's regional activities in recent decades provide a set of characteristics that make it possible to delineate its interests, pretensions and limitations for conducting this process. Perhaps with partial exception of Argentina and of some structural regional projects such as Itaipu and (to a lesser extent) GASBOL, Brazil has not opted to pursue strategies with its regional partners that have led to qualitative change, in relation to standards of economic, social or political development in these countries.

The combination of regional sectoral arrangements with weak institutional structure, that bolster the central policy-making role of Brazil in this process, with projects oriented toward a shallow process of integration, highly susceptible to changes in the political or economic context, indicate some very clear limits. At the same time, a fair degree of acceptance of Brazil as the main coordinating hub and instigator of this process, combined with a fair degree of capacity to

mobilize resources, as illustrated by achievements in the field of energy integration and the SIVAM program, provides significant indication of the feasibility of its political and programmatic strategies.

Central to this process is the predominance of a Brazilian posture of caution and reserve in relation to policy commitments and a determination to ensure that arrangements in the region remain capable of accommodating its interests and international ambitions, under an integrationist model that endows countries with space to pursue economic benefits and with varying degrees of political autonomy. At the root of this Brazilian ambivalence and of the widening gap between its regionalist diplomatic rhetoric and the reticence of its actual postures, is a lack of domestic consensus as to the benefits Brazil might reap from this regional project.

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