IN BRIEF

Parliamentary Research Branch
Library of Parliament

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1 April 2004

Free Trade With Brazil: A Priority for Canada

In October 2003 and again in December 2003, Brazil and its Mercosur partners (Argentina, Paraguay, Uruguay)(1) approached the Government of Canada to propose the launch of free trade negotiations, with the goal of finalizing an agreement by January 2005. For reasons set out below (see the section on Mercosur), Brazil could participate in any such negotiations through Mercosur.

According to the Brazilian Ambassador to Canada, Brazil would like to negotiate a free trade agreement with Canada to open up the Canadian market to Brazilian agricultural products in exchange for improved access to Brazil's manufacturing and services markets. In January 2004, Canada's Minister of International Trade (Hon. Jim Peterson) expressed Canada's reciprocal interest in entering into such negotiations as part of a new focus on bilateral deals with key emerging markets.(2)

WHY FREE TRADE?

A. Brazil Is a Priority Country

The economic relationship between Canada and Brazil dates from the 19th century. In 1866, Canada dispatched its first trade mission to Brazil. Early in the 20th century, a Canadian company (Brascan) became involved in supplying that country's two largest cities with electric power.

Canadian foreign policy in South America became heavily focused on Brazil after World War II. The country has been Canada's largest South American trading partner for many years, and represents a market in which over 500 Canadian firms participate.

As South America's most powerful economy and home to 175 million people, Brazil is currently one of only 11 "partner" countries designated by the Government of Canada.(3) Others include the members of the G8, China, India, and Mexico. However, what sets Brazil apart from the others is that, according to Mr. Peterson, it now heads the list of countries with which Canada would like to engage in bilateral trade negotiations.

Free trade between Canada and Brazil would help each country recognize the other as a valuable economic partner and would tap the as-yet-unrealized potential that a more vibrant bilateral relationship could offer. It would be useful in reducing the high levels of tariffs and quotas found within both countries on a number of agricultural goods, as well as Brazilian tariffs on manufactured products. The latter average approximately 13%.

B. Free Trade As a Competitive Tool

The appendix to this document clearly indicates that bilateral trade between Canada and Brazil remains below 1997 levels and has not kept pace with the growth in Canada's overall trade. This situation is due largely to Canada's export performance: Canadian exports to Brazil dropped from \$1.7 billion in 1997 to only \$0.9 billion in 2003.(4)

What would account for this situation? By far the biggest factor in Canada's reduced exports to Brazil was the economic turmoil in South America that spilled over from the Asian financial crisis in 1998. This financial contagion weakened Brazil's economy and its currency (the real), thereby hampering the competitiveness of Canadian exports. Other factors, including competition from Brazil's manufacturing sector, strong export activity from the European Union, the uncertainty over the October 2002 Brazilian elections, and the continued existence of a number of significant import barriers, combined to further lower Canadian exports to Brazil during 1998 to 2002.

While exports to Brazil in 2003 have rebounded, this recovery remains modest. An aggressive free trade agreement could provide a strong stimulus to bilateral trade and help Canada compete on an even footing in the Brazilian market with the European Union, whose trade agreement with Mercosur (see below) is to be fully implemented by 2005. It could also help spur additional Canadian investment in Brazil; as the appendix shows, such investment fell considerably during 2000 to 2002.

C. A Bilateral Agreement as Insurance Against Weak or Unsuccessful WTO and FTAA Negotiations

According to trade theory, bilateral agreements are less desirable than multilateral agreements, such as those currently being negotiated at the World Trade Organization (WTO) or to create a Free Trade Area of the Americas (FTAA). WTO negotiations, however, have stalled, at least for the moment. In the case of the FTAA, the objective of crafting a comprehensive agreement has already been downgraded. It is also uncertain whether the FTAA negotiators will meet the January 2005 target date for completion.

Given these developments, many countries have now turned their attention to the less cumbersome, albeit suboptimal, option of negotiating bilateral free trade arrangements. Free trade with Brazil could serve as a useful insurance policy against a lack of meaningful progress in the other trade negotiation venues.

ALL ROADS LEAD THROUGH MERCOSUR

The Mercosur regional organization has implemented a common external trade policy, meaning that it negotiates new trade agreements with other countries collectively, not individually. Since Brazil is a member of Mercosur, any free trade negotiations that are launched with Canada would have to take place under the Mercosur umbrella.

The latest push for free trade talks represents a significant advance in the existing Canada–Mercosur relationship. In June 1998, the Canada–Mercosur Trade and Investment Cooperation Arrangement was signed to lay the foundation for enhanced bilateral trade and investment. The free trade talks now being considered would likely broaden the trade relationship considerably.

Negotiating a free trade arrangement with Mercosur, as opposed to simply with Brazil, would also give Canada an opportunity to improve economic relations with Argentina, a key destination for Canadian foreign direct investment (FDI) in the Americas. In 2002, Canadian direct investment in Argentina totalled \$1.4 billion, up considerably from \$123 million in 1990. Bilateral trade, on the other hand, is down considerably from its 1997 peak of \$641 million. In 2003, the combined level of imports and exports between Canada and Argentina stood at \$454 million.

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(1) Mercosur is the name given to the Southern Cone Common Market, a regional organization established in 1991 that provides for the free movement of goods, services, capital and labour within its boundaries, a common external tariff and harmonized macroeconomic and sectoral policies by 2006. This grouping of countries, which also includes Chile and Peru as associate members, is attempting to consolidate economic activity while at the same time negotiating trade deals with the Andean Community (Bolivia, Colombia, Ecuador, Peru, Venezuela), the European Union and a number of other countries outside the Americas. Brazil is the key member of the country grouping.

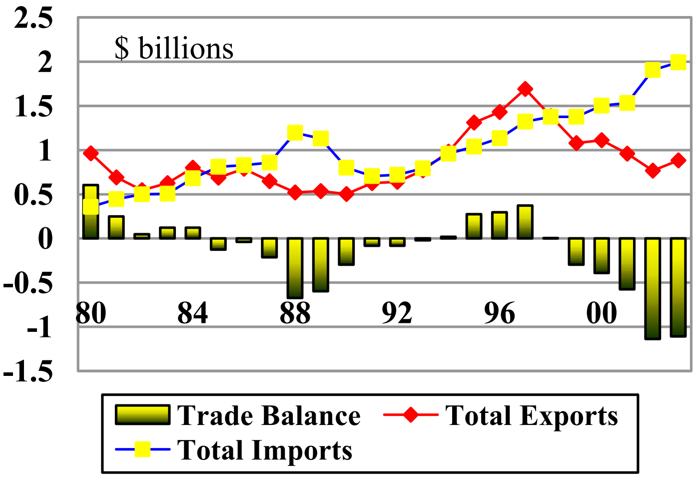
(2) Other key emerging countries include China and India.

(3) *Canada-Brazil Relations*, Department of Foreign Affairs and International Trade, January 2004 (available at www.dfait-maeci.gc.ca/latinamerica/brazilrelations-en.asp).

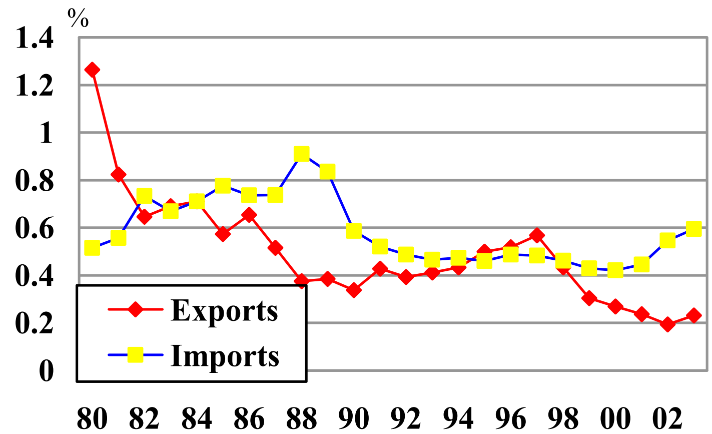
(4) On the other hand, imports registered strong growth, rising from \$1.4 billion to \$2.0 billion.

Appendix – Canada's Trade With Brazil

Merchandise Trade, 1980-2003



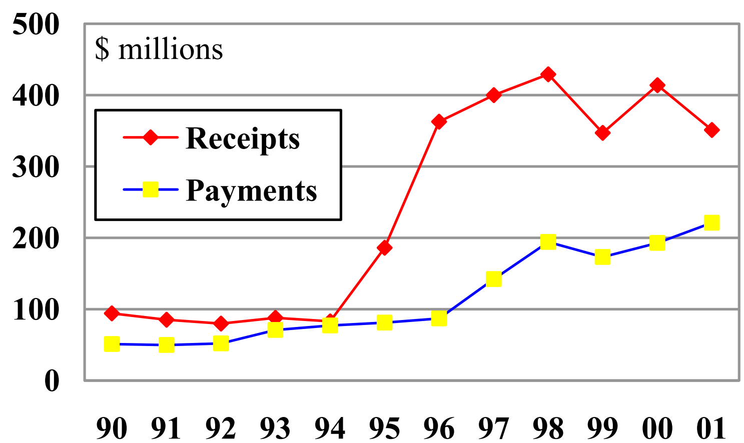
Merchandise Trade as a Share of World Total



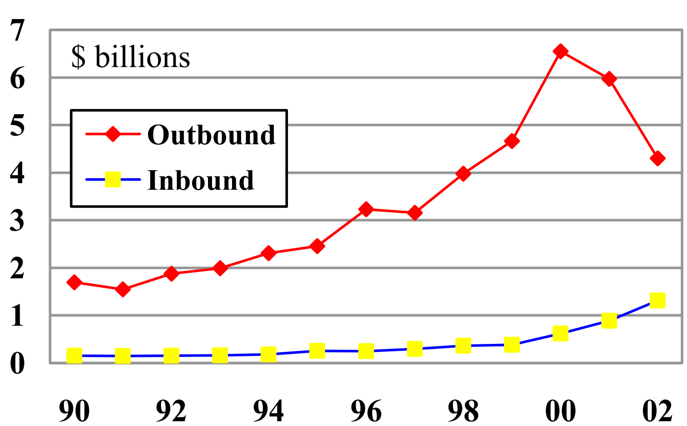
Major Export Products to Brazil

	Value ($millions)		Growth: 1990-2003	
	1990	2003	$millions	%/yr.
Fertilizers	43.8	182.5	138.8	11.6
Machinery and equipment	117.3	122.8	5.5	0.4
Paper and paper products	44.4	119.1	74.7	7.9
Mineral fuels and related	68.7	111.3	42.5	3.8
Cereals	58.9	65.4	6.5	0.8
Salt, sulfur, lime, stone, etc.	41.8	45.8	4.0	0.7
Electrical/electronic machinery & equip.	6.1	43.5	37.4	16.3
Optical, scientific & technical instruments	8.0	22.8	14.8	8.4
Motor vehicles, parts and related	0.2	17.2	17.0	39.0
Vegetables, roots, tubers	1.4	15.0	13.6	19.9
Rubber and articles thereof	9.9	14.8	4.9	3.1
Plastics and articles thereof	0.6	14.5	13.9	27.8
Inorganic chemicals & radioactive cmpds.	4.4	11.8	7.4	7.9
Pharmaceutical products	0.6	10.6	10.0	25.5
Organic chemicals	1.2	7.3	6.1	14.7
Sub-total	**407.4**	**804.4**	**397.0**	**5.4**
Others	95.0	77.0	-18.0	-1.6
Total	**502.4**	**881.4**	**379.0**	**4.4**

Trade in Services, 1990-2001



Foreign Direct Investment Stocks, 1990-2002



Major Import Products from Brazil

	Value ($millions)		Growth: 1990-2003	
	1990	2003	$millions	%/yr.
Iron and steel	65.6	257.4	191.8	11.1
Motor vehicles, parts and related	39.3	237.4	198.1	14.8
Sugars and confectionery	2.2	180.3	178.1	40.3
Machinery and equipment	84.8	174.9	90.1	5.7
Vegetable and fruit preparations	118.0	100.2	-17.9	-1.3
Wood and articles of wood	10.6	95.5	84.9	18.5
Electrical/electronic machinery & equip.	21.5	85.2	63.6	11.2
Inorganic chemicals & radioactive cmpds.	2.8	78.4	75.6	29.4
Footwear	69.1	75.6	6.5	0.7
Precious metals, coins, jewellery, etc.	1.3	62.9	61.6	34.5
Coffee, tea and spices	37.0	57.7	20.7	3.5
Leather, raw hides, skins	7.4	50.2	42.8	15.9
Ores, slag and ash	77.6	45.7	-31.9	-4.0
Fruits and nuts	18.0	38.7	20.7	6.1
Cocoa and cocoa preparations	21.5	38.5	17.0	4.6
Sub-total	**576.7**	**1,578.6**	**1,001.9**	**8.1**
Others	221.9	412.5	190.5	4.9
Total	**798.6**	**1,991.1**	**1,192.5**	**7.3**

Sources: Library of Parliament calculations using Statistics Canada data.