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BY THE U.S. GENERAL ACCOUNTING OFFICE  
Report To The Chairman, Subcommittee On  
International Economic Policy,  
Oceans And Environment  
Senate Committee On Foreign Relations

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## Emerging Issues In Export Competition: A Case Study Of The Brazilian Market

Concern over U.S. export competitiveness has risen sharply in the changing world trade environment. Developing countries now play a greater role in world trade, and the types of barriers faced by U.S. exporters have shifted from multilaterally negotiated tariffs to an imaginative variety of import restrictions. The lack of multilateral discipline covering these practices has allowed greater latitude for foreign competitors' varying trade techniques to affect U.S. firms' trade competitiveness.

This report, focusing on Brazil, identifies four restrictive trade practices that can affect export competitiveness in a country experiencing foreign currency shortages and restricting imports: (1) bilateral trade arrangements, (2) countertrade, (3) export financing, and (4) compliance with trade-related industrial policy requirements. GAO believes that the United States may have to develop case-by-case approaches to maintain competitiveness in areas where multilateral rules are not likely to be established in the near future.



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UNITED STATES GENERAL ACCOUNTING OFFICE  
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NATIONAL SECURITY AND  
INTERNATIONAL AFFAIRS DIVISION

B-217828

The Honorable Charles McC. Mathias, Jr.  
Chairman, Subcommittee on International  
Economic Policy, Oceans and Environment  
Committee on Foreign Relations  
United States Senate

Dear Mr. Chairman:

As part of our efforts to provide your Subcommittee with information on the international rules governing trade, this report discusses numerous emerging issues in export competition, using the Brazilian market as a case study. Changes in the world trading environment have created new challenges to the U.S. exporter; for instance, developing countries now play a greater role in world trade and the types of barriers faced by U.S. exports have shifted from multilaterally negotiated tariffs to an imaginative variety of import restrictions. In response to concern over U.S. competitiveness in this changing trade environment, this report identifies various forms of export competition that have developed to meet current restraints on world trade, specifically in developing country markets, and also explores the trade issues affecting U.S. exports that have emerged as a result of this competition.

We plan no further distribution of this report until 30 days from the date of issue, unless you publicly announce its contents earlier. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

A handwritten signature in cursive script that reads "Frank C. Conahan".

Frank C. Conahan  
Director

REPORT TO THE CHAIRMAN,  
SUBCOMMITTEE ON INTERNATIONAL  
ECONOMIC POLICY, OCEANS, AND  
ENVIRONMENT  
SENATE FOREIGN RELATIONS  
COMMITTEE

EMERGING ISSUES IN EXPORT  
COMPETITION: A CASE STUDY  
OF THE BRAZILIAN MARKET

D I G E S T

Over the last decade U.S. government and business concern over U.S. competitiveness in world export markets has heightened sharply, due to both the increasing importance of U.S. exports as a component of gross national product and the declining U.S. share in world markets. At the same time, foreign export competition has become more intense.

The world trading environment has also changed over the past decade, resulting in greater potential for bilateral trade arrangements to develop. Developing countries now play a greater role in world trade, and the types of barriers faced by U.S. exports have shifted from multilaterally negotiated tariffs to an imaginative variety of import restrictions. These restrictions often are not prohibited by existing international trade rules or are justified under infant industry, national security, or economic hardship rationales. This lack of multilateral regulation in many trading areas has helped to generate a trade environment in which the willingness to engage in bilateral practices has become an important competitive factor.

In response to Congressional concern over U.S. competitiveness in this changing trade environment, this report

- identifies various export techniques that foreign trade competitors have developed to meet the import restrictions and foreign exchange shortages which now typically restrain trade with developing countries, and
- explores the trade issues that have emerged as a result of this competition, and the application of existing multilateral trade rules to such trade issues.

GAO chose Brazil as a case study to illustrate new forms of export competition because: (1) its trade environment--dominated by foreign exchange shortages and import restrictions--encourages innovative trade practices, (2) it represents an important market for U.S. export trade, and (3) it is the first and only country thus far with which the United States has signed a bilateral trade accord meant to match the exclusionary trade accords of U.S. competitors. (See ch. 2.)

GAO focused on three high-technology sectors of the Brazilian market in which the United States has historically been competitive and which are considered growth sectors for imports over the next decade: (1) electric energy, (2) computers/telecommunications ("informatics"), and (3) aircraft/avionics. GAO also identified France, Japan, and West Germany as major trade competitors in the Brazilian market.

#### NEW FORMS OF EXPORT COMPETITION

GAO's review identified four trade practices which are considered key factors in export competitiveness in Brazilian markets. These include: (1) bilateral trade accords, (2) countertrade, (3) export financing, and (4) compliance with trade-related industrial policy requirements.

#### Securing market access through bilateral trade accords

Because the Brazilian government has used detailed, government-to-government agreements, rather than open competitive bidding, in awarding major project contracts in some sectors, U.S. firms had been virtually excluded from these markets. The United States has had no basis under existing multilateral rules to complain about the use of such exclusionary trade practices because they are not prohibited by the General Agreement on Tariffs and Trade (GATT) and, Brazil, like most developing countries, has not signed the Government Procurement Code of the GATT.

In 1982 the U.S. government recognized such bilateral accords as the only way to compete for access to parts of Brazil's large energy market, and in April 1983 it signed similar accords or Memorandums of Understanding (MOUs) with the Brazilian government for developing Brazil's hydroelectric and thermoelectric resources. These accords represent a potentially significant new approach in U.S. trade policy toward imitating the exclusionary bilateral trade practices of U.S. competitors.

U.S. exporters support the use of these accords worldwide, since they believe that they are often disadvantaged in overseas markets due to competitor government involvement.

#### Countertrade: a growing phenomenon

Countertrade appears to be a small but recently growing phenomenon in a number of developing nations which, faced with foreign exchange shortages, increasingly encourage or require countertrade arrangements. Broadly stated, a countertrade transaction sets up a link between the buyer and the seller, obliging the seller to purchase certain goods from the buyer in order to offset the price of the original sale. Thus countries, like Brazil, which are troubled by illiquidity, see countertrade as one means of obtaining imports while retaining scarce foreign exchange, with the additional bonus of guaranteed export markets. Despite these advantages, countertrade can hold somewhat hidden disadvantages as well. (See ch. 3.)

Although countertrade threatens an open, non-discriminatory multilateral trading system by foreclosing market sectors from competition based on price and quality, its use is not prohibited by international or U.S. law. Government mandated countertrade is strongly opposed by U.S. and GATT policy, however.

GAO's review found that Brazil considers the willingness to countertrade a significant competitive factor in certain market sectors. Although its government does not formally promote countertrade, Brazil has been cited as one of the most prominent countries outside the

Eastern Bloc using countertrade. Although countertrade deals are difficult to document, business sources estimate countertrade at 2 percent to 50 percent of total Brazilian trade, and U.S. firms expect this figure will rise.

#### Competition in export financing

For several years before Brazil's financial problems reached the crisis stage in late 1982, competitor governments seeking to win sales to Brazil pursued aggressive export-financing programs. Since late 1982, however, competitor medium- and long-term export financing for Brazil has virtually dried up, and the U.S. Export-Import Bank (Eximbank) has led in making available continued export financing to Brazil. (See ch. 4.)

Still, foreign competitor governments do generally offer a wider range of export support programs--such as inflation risk insurance, mixed credits, and local cost support--than does the United States. Another important difference is that Eximbank, as a matter of policy, provides financing for specific projects, whereas France and Japan may also approve general purpose lines of credit.

Although the Organization for Economic Cooperation and Development (OECD) has an Arrangement on Official Export Credits which stipulates minimum interest rates and maximum credit terms for official medium- and long-term export credits, other financing methods not disciplined by this Arrangement have become competitive factors in Brazil. These methods include parallel financing (unrelated and additional financing), leasing arrangements, and the use of mixed credits or (low interest development assistance funds blended with export credits). (See pp. 51-59.)

#### Compliance with trade-related industrial policy requirements

Brazil has been a leading country in targeting certain industries for accelerated, government-supported national development. Brazil's goal is to replace imported products and technologies with Brazilian ones and, in the process, alleviate its balance-of-payments deficits. (See ch. 5.)

Foreign firms interested in exporting to Brazilian markets face protective import restrictions, preferential government procurement practices, and investment performance requirements such as technology transfer, use of Brazilian-made components, export requirements, and Brazilian majority ownership requirements.

The trade effects of such restrictive policies may be that whole sectors are closed to foreign imports in order to protect the local developing industry. This has been the case, for example, since the 1970s, when Brazil targeted certain segments of its informatics and aircraft sectors for national development. As a result, foreign exporters of these products were closed out or had to transfer technology and locate in Brazil to compete in its market.

Investment performance requirements are proliferating in Brazil and in the developing world overall. U.S. efforts to bring these under the General Agreement on Tariffs and Trade have met with resistance from both developing and industrialized countries. Without established international discipline, there is wide latitude for foreign countries and firms to respond to Brazil's industrial targeting practices.

GAO did not find definitive answers to the question whether foreign competitors in Brazil have been more responsive than U.S. firms in complying with such investment performance requirements, nor did GAO find competitor government support for such an approach. The U.S. business community does perceive foreign competitors as being more compliant with these requirements, however.

### CONCLUSIONS

To be competitive in sectors of the Brazilian market, the United States may need to engage in innovative trade arrangements that accommodate Brazil's financial problems, industrial targeting strategies, and procurement preferences. These types of arrangements are not, for the most part, governed by multilateral rules, and foreign competitors' varying bilateral practices have become competitive factors. U.S. trade

policy typically seeks multilateral solutions to trade issues and GAO believes the U.S. government should continue to assess what issues are likely to be resolved through multilateral efforts. For those areas where no near-term progress in establishing multilateral rules is likely, however, GAO believes the U.S. government needs to focus its attention on developing creative, case-by-case responses, particularly if these responses encourage other countries to seek multilateral solutions.

#### AGENCY COMMENTS

The Commerce and State Departments and Eximbank commented that the United States has maintained its competitiveness in the Brazilian market and that the report does not prove that the trade practices discussed have in fact affected U.S. exports. GAO emphasizes that the report's purpose was not to draw conclusions regarding overall U.S. competitiveness in Brazil. Rather, it was to identify trading practices that a country, such as Brazil, has itself indicated are competitive factors in certain market sectors. It seems inescapable that countries willing to comply with Brazil's trading preferences will win market share. For example, in the electric generating market-- one in which U.S. firms compete well worldwide--U.S. firms had been excluded due to other countries' willingness to use MOUs.

Commerce also stated that these trade practices may be unique to Brazil. GAO notes that only the bilateral MOU technique has so far been unique to Brazil; the other trade practices discussed in the report--trade-related investment requirements, competitive export financing techniques, and countertrade--have become pervasive in the global market. The U.S. business community is seriously concerned about them, and they have been the subject of discussions and negotiations within the GATT and the OECD.

Commerce, State, and the Office of the U.S. Trade Representative also expressed their view that the report overemphasizes the significance of the U.S. bilateral accords with Brazil. GAO made it clear in the report that the MOUs so far cover only a few products and projects. However, Commerce gave considerable publicity to

this effort and even in their comments asserted that the MOUs could have application in other countries.

Commerce and State also questioned GAO's questionnaire methodology and results. GAO notes that its questionnaire was developed by questionnaire and statistical experts and was pre-tested with U.S. exporters to Brazil. GAO notes that Commerce provided no support for its assertion that the GAO survey data does not reflect the respondents' views.

Many of the specific comments, particularly those provided by Eximbank, were used to update and clarify matters discussed in the report. The Treasury Department did not provide comments on this report.

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ABBREVIATIONS

FCS	Foreign Commercial Service
GATT	General Agreement on Tariffs and Trade
IMF	International Monetary Fund
LAIA	Latin American Integration Association
LDC	Less developed country
MOU	Memorandum of Understanding
OECD	Organization for Economic Cooperation and Development

## CHAPTER 1

### INTRODUCTION

During the last decade, U.S. government and business concern over U.S. competitiveness in world export markets has heightened sharply, due both to the increasing importance of U.S. exports as a component of gross national product (GNP)<sup>1</sup> and to the declining U.S. share in an expanding world market.<sup>2</sup> With the U.S. economy now inextricably linked with world trade, the recession-induced contractions in 1981 and 1982 in the value and volume of world trade and the unprecedented size of the U.S. trade deficit have further sharpened U.S. interests in its ability to compete for world markets.

At the same time, exporter competition for markets has become more urgent and aggressive. The primary export competitors of the United States also have an increased stake in the world export market, in terms of GNP generated from exports, and except for Japan also have seen declines since 1970 in their shares of world exports.

The world trading environment has also changed over the past decade to allow greater latitude for bilateral trade arrangements. Less developed countries (LDCs) now play a greater role in world trade, and the types of barriers faced by U.S. exports have shifted from multilaterally negotiated tariffs to an imaginative variety of import-restrictive measures. These restrictions often are not governed by existing international trade rules or are justified under infant industry, national security, or economic hardship rationales. Such an environment provides clear opportunities for countries to solve trade issues through bilateral trade arrangements or other individual responses to these new types of restrictions.

This report is an effort to (1) identify forms of export competition developed in response to the changing trade environment in an important export market and (2) highlight the trade issues that have emerged as a result of this competition. Each chapter deals with a type of export practice that we found to be a significant competitive factor, the trade issues arising from it, and the applicability of multilateral rules to these issues.

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<sup>1</sup>U.S. exports as a percentage of GNP grew from 4.3% in 1970 to 9.9% in 1984.

<sup>2</sup>The U.S. share of free world exports declined from 15.4% in 1970 to 12.8% in 1982, while the value of world exports grew by about 600% over this same time.

## WHY BRAZIL?

We chose Brazil as a case study capable of illustrating new forms of export competition because (1) it is a presently difficult but potentially very important market in itself and those seeking to export there would have to be innovative in their trading practices, (2) the major factors affecting exports to Brazil--foreign exchange shortages and industrial policy-related import restrictions--have become increasingly common around the world and comparisons of U.S. and foreign competitors' reactions to these can signal emerging competitive differences, and (3) it is the only country so far with which the United States has signed a bilateral trade accord meant to match the exclusionary trade accords used by its competitors in Brazil and elsewhere.

Within Brazil, we focused on three high-technology sectors in which the United States has been and is expected to continue to be competitive--electric energy, computers/telecommunications ("informatics"), and aircraft/avionics. These three broadly defined sectors are also considered growth sectors for Brazilian imports and are already targets of aggressive exporter competition.

The countries we selected as major export competitors are Brazil's currently top developed-country suppliers: France, Japan, and West Germany. Market shares of Brazil's non-oil imports are: 30 percent for the United States, 12 percent for West Germany, 8 percent for Japan, and 5 percent for France. In the aircraft/avionics sector France is the primary competitor, and all three are major competitors in the other two sectors.

## BRAZIL'S TRADING ENVIRONMENT

Like many developing countries, Brazil's trading environment is characterized by two major forces: (1) foreign exchange shortages requiring import restraint and export expansion efforts and (2) the determination to carry out its ambitious national development goals through industrial targeting policies, often limiting the types of imports allowed into the country.

### Origin of Brazil's financial crisis

Brazil's foreign debt crisis had its origins in Brazil's reluctance after the 1974 "oil shock" to slow its ambitious national development program, with the result that its current account deficit quadrupled. The Brazilian government chose to finance this deficit through foreign borrowing rather than adopting austerity measures to reduce import demand. Brazil's foreign debt grew, and by 1976 interest payments became the

largest single component of its current account deficit, surpassing the trade deficit as the major cause of debt growth. By the late 1970s, worldwide inflationary pressure and economic recession had brought sharply higher interest rates and cuts in Brazil's export growth. As a result, Brazil's debt service ratio reached 96 percent in 1982--i.e., virtually all export earnings were consumed in making interest and principal payments on its external debt.

By mid-1982, especially after the Mexican debt crisis in August 1982, foreign bankers lost confidence in Brazil's ability to overcome its problems and cut off Brazil's access to medium and long-term credits but still permitted short-term credits. This caused Brazil's short-term borrowings to escalate sharply and, combined with banker worries about the debt situations of major foreign borrowers, led in December 1982 to a total collapse of lending to Brazil. Remaining short-term credit lines to Brazil evaporated, rendering Brazil unable to meet its external financial obligations. An interim payments moratorium was declared, during which Brazil, the banks, creditor governments, central banks, and the International Monetary Fund (IMF) cooperated to arrange a multi-billion dollar bridge financing package, allowing Brazil to meet debt service payments until a longer term strategy for managing its debt problem was in place.

The primary objective of this economic adjustment program, implemented in mid-1983, has been to restrain debt growth and encourage trade surpluses to the point where debt service payments are manageable and lender confidence is restored. Trade surpluses had to be achieved initially by cutting imports and, if possible, increasing exports. Steadily rising Brazilian exports would then permit some resumption of Brazil's import growth and new productive investment. Even so, it is generally agreed that Brazil will still have to achieve huge trade surpluses throughout the 1980s, especially if international interest rates fluctuate higher.<sup>3</sup>

### Brazil's balance of trade

To offset the debt service payments on its presently more than \$100 billion foreign debt (as of early 1985), Brazil has sought to achieve trade surpluses primarily by drastically cutting imports, since its export expansion strategy was undercut by the world recession in the early 1980s.

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<sup>3</sup>About three-fourths of Brazil's total debt is tied to floating interest rates, and the U.S. Treasury estimates that for every 1 percent rise in U.S. interest rates, Brazilian debt payments rise by \$750 million a year.

Brazil's trade balances during 1980-83 with the United States, France, Japan, and West Germany are shown in table 1. The United States now holds by far the largest trade deficit with Brazil. In fact, of Brazil's trade surpluses with the world, the United States accounted for about 56 percent in 1981, 108 percent in 1982, and 37 percent in 1983. In 1983 and 1984, Brazil actually exceeded its IMF targets, raising its trade surplus to over \$6 billion in 1983 and to well over its \$9 billion target in 1984.

Table 1

Brazil's Trade Balances With France, Japan,  
the United States and West Germany

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
		(millions)			
France	\$ 157.8	\$ 254.6	\$ 322.1	\$ 434.6	\$ 464.9
Japan	166.0	-20.3	413.6	872.0	962.0
United States	-591.4	607.7	1,173.0	2,654.3	5,412.9
West Germany	-257.2	241.1	288.9	426.0	626.6

Source: Government of Brazil trade statistics.

The shares of the United States and its competitors in Brazil's non-oil import market are shown in table 2, and the shares of each country in the three sectors we studied are shown in table 3. Clearly, the United States is the major supplier in each of these sectors, although the Foreign Commercial Service in late 1983 warned of increasing third-country competition in the Brazilian market.

Table 2

Shares of Brazil's Non-Oil Import Market

	<u>1979</u>	<u>1980</u>	<u>1981</u> (millions)	<u>1982</u>	<u>1983</u>	<u>1984</u>
Total imports	\$18,084	\$22,955	\$22,091	\$19,397	\$15,429	\$13,916
Crude petroleum	<u>-6,266</u>	<u>-9,368</u>	<u>-10,547</u>	<u>-9,568</u>	<u>7,822</u>	<u>6,735</u>
Non-oil imports	11,818	13,587	11,544	9,829	7,607	7,181
United States	3,240 (27.4%)	4,101 (30.2%)	3,504 (30.4%)	2,849 (29.0%)	2,409% (31.7)	2,297 (32.0%)
Japan	1,085 (9.2%)	1,066 (7.8%)	1,240 (10.7%)	877 (8.9%)	561% (7.4)	563 (7.7%)
West Germany	1,356 (11.5%)	1,594 (11.7%)	1,076 (9.3%)	858 (8.7%)	705% (9.3)	629 (8.8%)
France	571 (4.8%)	665 (4.9%)	597 (5.2%)	561 (5.7%)	456% (6.0)	371 (5.2%)

Source: Bank of Brazil.

Table 3

Brazil's Imports By SectorTelecommunications<sup>a</sup>

	<u>1979</u>	<u>1980</u>	<u>1981</u> (millions)	<u>1982</u>	<u>1983 (est.)</u>
United States	\$ 61.8	\$ 69.4	\$ 75.8	\$ 34.5	\$111.5
West Germany	29.3	19.9	18.7	10.5	13.3
Japan	65.5	47.9	46.1	30.1	97.4
France	10.9	2.6	3.5	3.6	1.5
United Kingdom	12.1	8.5	4.7	1.2	5.7
Sweden	6.0	3.6	18.2	4.9	2.6
Others	<u>50.6</u>	<u>19.0</u>	<u>15.1</u>	<u>13.2</u>	<u>23.0</u>
Total	<u>\$236.2</u>	<u>\$170.9</u>	<u>\$182.1</u>	<u>\$98.0</u>	<u>\$255.0</u>

<sup>a</sup>Includes telegraph, telephone and carrier wave equipment and telephone and carrier wave equipment and spare parts, frames, terminal boxes, radio telephone and telegraph transmitters and receivers, and broadcasting equipment and parts.

Informatics<sup>a</sup>

	<u>1979</u>	<u>1980</u>	<u>1981</u> (millions)	<u>1982</u>	<u>1983 (est.)</u>
United States	\$43.0	\$50.5	\$59.9	\$64.2	\$51.7
West Germany	4.4	9.1	1.6	1.3	1.0
Japan	17.0	12.0	19.9	17.3	5.2
France	6.2	7.8	8.4	7.1	1.8
United Kingdom	1.3	3.7	3.6	0.9	1.6
Switzerland	9.3	1.8	2.1	4.3	24.2
Others	<u>3.2</u>	<u>4.3</u>	<u>20.8</u>	<u>8.1</u>	<u>7.1</u>
Total	<u>\$84.4</u>	<u>\$89.2</u>	<u>\$116.3</u>	<u>\$103.2</u>	<u>\$92.6</u>

<sup>a</sup>Includes data processing equipment, peripherals (printers, terminals, desk and tape drives, data entry terminals, etc.) digital circuits, etc.

Energys

	<u>1979</u>	<u>1980</u>	<u>1981</u> (million)	<u>1982</u>	<u>1983(est.)</u>
United States	\$268.3	\$293.2	\$298.7	\$277.3	\$215.6
West Germany	140.6	139.1	126.5	119.6	67.9
Japan	222.9	216.2	293.8	309.2	195.8
France	79.5	149.4	89.7	73.2	36.5
United Kingdom	41.0	79.2	68.5	16.0	31.0
Sweden	16.0	20.5	58.0	181.5	45.5
Others	<u>274.8</u>	<u>265.5</u>	<u>203.4</u>	<u>182.6</u>	<u>101.5</u>
Total	<u>\$1,043.1</u>	<u>\$1,163.1</u>	<u>\$1,138.6</u>	<u>\$1159.4</u>	<u>\$693.8</u>

<sup>a</sup>Includes electrical power generating equipment, transformers, voltage accumulators, etc.

Aviation/Avionics<sup>a</sup>

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983 (estimated)</u>
	(millions)				
United States	\$ 85.8	\$365.1	\$191.3	\$ 82.7	\$272.1
West Germany	4.6	5.6	3.8	2.0	8.3
Japan	2.8	1.8	2.7	3.9	10.3
France	12.4	99.1	61.5	170.9	20.2
United Kingdom	11.8	4.7	7.3	8.1	5.8
Canada	11.8	25.0	22.1	4.0	16.7
Holland	2.1	3.0	1.2	2.1	12.4
Italy	3.0	15.5	2.5	2.9	4.3
Others	<u>12.1</u>	<u>9.3</u>	<u>6.0</u>	<u>7.2</u>	<u>27.3</u>
Total	<u>\$146.4</u>	<u>\$529.1</u>	<u>\$298.4</u>	<u>\$283.2</u>	<u>\$377.4</u>

<sup>a</sup>Includes jet, turboprop, and propeller aircraft; helicopters; flight simulators and parts; radar systems; radio navigational apparatus; cargo handling equipment; engines; tires; parts and accessories, etc.

Source: U.S. embassy, Brazil.

Brazil's industrial targeting policies

Brazil's ambitious national development plans are embodied both in generally applicable import restrictions and in various sector-specific development plans.

All imports require an import permit issued by CACEX, the Foreign Trade Department of the Banco do Brasil. Under Brazil's Law of Similar, import licenses are not allowed for items already made in Brazil or considered superfluous or luxurious. In 1980 CACEX began requiring each company to obtain approval for expected import needs throughout the year. Priority is given to import applications from firms which have contracted to export products from Brazil or to contribute to Brazilian energy development programs as a condition for obtaining import licenses.

Special taxes and tariff surcharges have also been placed on imports. The Tax on Financial Operations, ranging up to 25 percent, is a tax on the value of foreign exchange purchased for most imports. Tariff surcharges of 30 to 100 percent on several thousand items were removed in late 1984 and were replaced in some cases by a higher basic duty. Since 1980 Brazil has effectively required foreign financing on imports of capital equipment, consumer products, and chemical and steel products, although recently this requirement has been relaxed. Also, from mid-1983 to March 1984 the Central Bank centralized all foreign exchange transactions, delaying payments for most imports.

For some sectors, the Brazilian government follows a "market reserve" policy, reserving certain markets for domestic producers by controlling imports and foreign direct investments. This policy is now being applied most actively to the high-technology areas, especially the "informatics" sector,<sup>4</sup> for which imports must be specifically approved, since the Brazilian government maintains that its control of this sector is a national security interest. This market reserve policy also applies to part of the energy and aircraft sectors. (See ch. 5 for a description of such policies.) Sectors selected for priority Brazilian development receive various tax and subsidy benefits, as well as protection from import competition, and foreign investments in these sectors are controlled through such investment performance requirements as Brazilian majority equity, technology transfer, local content, and export requirements.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

We did this review to identify export practices developed in response to the changing world trading environment and their possible effects on U.S. exports. We visited Brazil and Japan and held discussions with U.S. embassy representatives, Brazilian and Japanese government officials, and U.S. and Brazilian businessmen. The overseas work was supplemented, at our request, by information from U.S. embassies in West Germany and France. We also talked with officials of agencies cognizant of Brazil-U.S. trade relations and many private sector representatives. We also examined official government files and cable traffic. Most of our review work was done in 1984 and early 1985, before 1984 trade statistics became available. Also, the March 1985 change of administration in Brazil may mean changes in some of the policies discussed in this report.

To help us analyze the experiences of the selected U.S. industries in Brazil and their knowledge of competitor export practices, we designed and sent a questionnaire to 273 high technology firms believed to have recently been active in the Brazilian market. (See app.I.) The primary source document for our mailing list was the November 1980 publication by the Brazilian-American Chamber of Commerce entitled the "U.S.-Brazil Business Listing." This listing is a compilation of over 900 firms, subsidiaries, and affiliates operating in and/or having interest in the United States and Brazil. We supplemented this list with lists from the Brazil-U.S. Business Conference and

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<sup>4</sup>In this report we are defining informatics in the broadest terms, encompassing computer hardware and peripherals, software and data processing services, semiconductors, transborder data flows, and telecommunications equipment and services (referred to in Brazil as "telematics.")

Department of Commerce. The response rate to our questionnaire was 84 percent.

This review was performed in accordance with generally accepted government auditing standards.

#### AGENCY COMMENTS AND GAO RESPONSE

Regarding our use of Brazil as a case study illustrating certain trade practices, the Commerce Department stated that the trade practices explored in the report may be unique to Brazil. (See app. III.) We believe that Commerce should have recognized that three of the four trade practices described in the report are pervasive in the global market, particularly in developing countries: trade distorting investment performance requirements, predatory export financing, and countertrade do concern the U.S. business community and are more fully recognized by other U.S. government trade agencies. Bilateral trade arrangements appear to have been used exclusively in Brazil, and Commerce itself still states these may have application in other countries.

The Commerce and State Departments and Eximbank comments noted, and we agree, that the United States has maintained its competitiveness in the Brazilian market over the past several years, holding about 30 percent of Brazil's imports despite the dollar's recent strength. They also noted that our report did not prove that the trade practices identified in the report have in fact affected U.S. export competitiveness in Brazil.

We emphasize that the purpose of our study was not to draw such conclusions regarding overall U.S. competitiveness in Brazil. Rather, it was to identify trading practices that a country such as Brazil has itself indicated are important competitive factors in certain market sectors--bilateral trade accords in parts of Brazil's electric energy market, compliance with Brazilian trade-related investment requirements in informatics and light aircraft, and countertrade and concessionary export financing offers wherever they can be arranged to benefit Brazil's foreign exchange position. The actual trade effects of these competitive practices cannot be measured in terms of realized market share except in comparison with what the share would have been without these distorting practices. Commerce provided no such analysis to support its assertion. We believe that such trade practices should be viewed as current and potential threats to the export competitiveness of U.S. firms, and we found that the U.S. business community shares our concern about these. We also found individual Commerce and State staff following these potential problems, Embassy cables documenting them, and specific instances where U.S. exports appear to have been affected.

Commerce and State also questioned the methodology and findings of our questionnaire. Our questionnaire (see app. I) was developed with the assistance of questionnaire and statistical experts and was pre-tested with U.S. exporters to Brazil. It was directed at a statistically valid sample of U.S. exporters to Brazil and the response rate was over 80 percent. Commerce did not provide any basis for its assertion that the survey data may not reflect the respondents' views.

## CHAPTER 2

### SECURING MARKET ACCESS THROUGH BILATERAL TRADE ARRANGEMENTS

According to U.S. government and business representatives, the Brazilian government has long used detailed, government-to-government agreements, rather than open competitive bidding processes, as the basis for awarding long-term major project contracts in some sectors. In late 1982 the U.S. Commerce Department recognized such bilateral accords as the only way to compete with foreign competitors for access to important sectors of Brazil's large energy market, and in April 1983 it signed several similar accords, or Memorandums of Understanding (MOUs), with the Brazilian government for developing Brazil's hydroelectric and thermoelectric resources.

These MOUs were highly publicized in the United States as a flexible response to export competitors' trade practices and as the first of a possible series of such bilateral accords elsewhere in the world intended to match competitors' trade practices. These accords have so far moved on schedule in terms of American businesses working together with Brazilian partners, and Commerce predicts that they could result in over \$1 billion in U.S. exports to a Brazilian sector dominated by European exporters. Export-Import Bank of the United States (Eximbank) support for such exports is considered vital but is not in any way tied to or presumed for these special MOU projects.

These bilateral accords represent a potentially significant harder line in U.S. trade policy, in the sense that in this instance the U.S. government response to an exclusionary trade practice--the reservation of certain Brazilian sectors for designated suppliers--has essentially been to imitate it. The United States has no recourse for complaining multilaterally about this practice, because Brazil has not signed the Government Procurement Code of the General Agreement on Tariffs and Trade (GATT), the only multilateral trade accord governing this kind of practice.

Commerce Department interest in applying this bilateral arrangement technique elsewhere, however, has waned somewhat since early 1983, due to its desire to concentrate on achieving success with it in Brazil and the need to identify other countries where it might be appropriate.

## COMPETITORS DOMINATE SOME BRAZILIAN SECTORS THROUGH BILATERAL ACCORDS

In the three sectors we studied, bilateral accords were a key competitive factor for electric power generation and ground avionics equipment. Although the details of such accords are considered proprietary, in general they reportedly specify participating firms, export financing and additional credit terms, and performance timetables.

We also encountered reports that competitors have similar detailed accords in other sectors, such as transportation and agriculture. According to Commerce officials, European groups--particularly the French, Swiss, and Germans--have dominated parts of the electric power generation area through such agreements; and in the ground avionics area, the French have predominated over at least the past decade as a result initially of such an agreement.

We did not find such accords to be a factor in the informatics sector. We were told the Brazilian ministries differ in their procurement policies: the Ministry of Mines and Energy prefers such detailed accords with individual countries at least partly as a means to generate additional foreign financing, whereas the other ministries may prefer competitive bidding on major projects.

In late 1982 the U.S. embassy in Brazil determined that U.S. firms would not be able to participate in Brazil's electric energy market unless an agreement could be reached with the Brazilian government similar to the accords signed by the Europeans. These European accords with Brazil in the energy sector have usually involved detailed information on projects, participating firms, and financial and operational terms. In most cases, the accords were concluded at the ambassadorial and ministerial levels and occasionally at the head-of-state level.

U.S. firms have not competed actively in the ground avionics area, according to Commerce officials, even though over the long term it is a potentially strong market due to Brazil's need to develop and modernize its airports. Elsewhere in the world, however, U.S. firms are competitive in this area. The U.S. embassy presently is not actively pursuing the MOU approach in the ground avionics area.

### U.S.-BRAZILIAN MOUS

Covering specific Brazilian electric projects, these MOUs were signed by the U.S. Commerce Department and the Brazilian Ministry of Mines and Energy in April 1983. They give U.S.

firms specific periods of time to select Brazilian partner companies, formulate project proposals, and have these approved by appropriate Brazilian government agencies. (See app. II for a copy of one of these MOUs.) If these steps are completed, the MOUs in effect give U.S. firms the "right of first refusal" for these projects. The projects are not, however, guaranteed to U.S. suppliers, because Brazil will still consider financing terms as well as price and quality in making procurement choices. The time periods specified extend to December 31, 1985, for completion of some of the commercial contracts.

Unlike the accords signed by the Europeans, the U.S.-Brazilian MOUs do not specify individual firms and financing arrangements. The role of the U.S. government is not to direct the assembly of the package deal but simply to use its good offices to help American firms conclude commercial contracts with Brazilian partners.

The U.S.-Brazilian MOUs are progressing on schedule. For four of the five accords, U.S. and Brazilian companies had preliminary contracts by April 1984--well within the time period allowed. The fifth project involves a coal gasification plant for which a feasibility study is first needed and which the U.S. Trade and Development Program has agreed to finance.

The next step is for the Brazilian government to provide the U.S.-Brazilian consortia with the basic technical specifications and instructions. Within 180 days after receiving these, the consortia must submit their technical, commercial, and financial proposals to the Brazilian government, which will evaluate them to see that they are internationally competitive. As of December 1984, three preliminary contracts were at this stage with the Brazilian government, and one project had progressed to the later stage where it has received Brazil's technical specifications and its technical and financial package was being prepared for Brazilian consideration.

U.S. exports resulting from these MOUs are expected to amount to about \$1 billion over 8 years, which would represent 20 to 30 percent of the equipment value for these projects. The U.S. embassy in Brazil estimates that, with the signing of commercial contracts, U.S. exporters will have at least a 35 percent share of the electric energy market, compared with the virtual exclusion of the U.S. firms from this market over the past decade.

#### U.S. clearance process for MOUs

The initial idea and impetus for these U.S. MOUs came from the former U.S. ambassador to Brazil and the U.S. commercial counselor in Brasilia. Although some parts of the Washington

trade bureaucracy hesitated about using this unprecedented approach, the MOUs were drafted and signed over a relatively short time period--about 4 months--and few questions were raised in the interagency clearance process about the trade policy implications of encouraging exclusive bilateral trade arrangements.

The major concern during the clearance process was whether the MOUs represented a U.S. government commitment to provide export financing for the expected U.S. equipment exports. Eximbank objected to any mention in the MOUs of Eximbank support because its policy is to consider financing requirements only for individual items for specified projects and not to authorize any line of credit, as might have been implied if Eximbank financing had been mentioned. Consequently, there is no mention in the MOUs of financing, even though Commerce publications state that Eximbank financing is expected and Commerce officials consider Eximbank support crucial to the successful completion of the commercial contracts.

#### Financing uncertainty

U.S. businesses participating in the U.S.-Brazilian consortia formed as a result of the MOUs do consider Eximbank financing availability and terms to be crucial to the conclusion of final contracts. Some businesses expressed confusion over the contrast between Commerce's active interest in seeing U.S. firms win these contracts and Eximbank's caution about what it might be able to support. Certainly, the signing of the MOUs can be interpreted as signaling special U.S. interest in achieving these U.S. exports, particularly since this type of MOU is a first for the U.S. government, has been highly publicized, and thus has engendered special expectations.

With one exception, the projects as of January 1985 had not progressed to the point where U.S. businesses have formally requested Eximbank support, and so the extent of support Eximbank will provide remains unclear. For the one project where the U.S. firm is preparing a package offer, Eximbank has approved a preliminary commitment.

Financial considerations will be very important in Brazil's final procurement decisions, and such contracts are not being reserved for U.S. firms. In fact, Brazilian firms could do the work and supply much of the equipment themselves, and Commerce reports that the Brazilian government has in the past made a deliberate decision to trade off some jobs in Brazil to obtain incremental financing through the MOU process with other countries. Thus foreign competition still exists for the U.S. exporters, a condition necessary for U.S. Eximbank support.

## U.S. Brazilian MOUS in other sectors

The U.S. embassy in Brasilia has sought to identify other sectors in Brazil for which MOUs can be negotiated. The U.S. Department of Transportation in March 1984 signed a technical MOU covering cooperation in transportation, but there is not necessarily any progression to a commercial contract. Currently under discussion are a U.S. commercial MOU in the fisheries area and a technical MOU in the environmental area.

## COMPETITORS' USE OF BILATERAL AGREEMENTS ELSEWHERE

In a preliminary effort to determine whether such an MOU-approach might be appropriate and desirable elsewhere in the world, Commerce in June 1983 requested 28 Foreign Commercial Service (FCS) posts to provide information on host government procurement practices. The responses received generally did not reflect situations similar to Brazilian procurement practices, with most posts reporting the prevalence of competitive bidding practices for major projects.

Only one post, Ecuador, reported the common use of MOUs in several sectors and noted that this approach would in time become a normal way of negotiating with the government, especially when tied to barter and compensation agreements. Although such agreements are usually considered proprietary by the parties, as they are in Brazil and Ecuador, Commerce assumes that its FCS posts overseas would in most cases at least be aware of their existence as a possible obstacle to U.S. exports.

In assessing the extent of such bilateral practices elsewhere, an important difficulty exists in defining what constitutes a bilateral trade arrangement similar to those in Brazil. Because the interactions between government and business are closer in France and Japan, for example, than in the United States and because package deals, including government financing, can be arranged with the governments as active participants, formal trade "agreements" are not always necessary. Such package deals are more common features of the international bidding process for major projects than the detailed, government-to-government agreements that Brazil prefers for some sectors. Some FCS posts, for example, cited the prevalence of package deals for major projects and the disadvantages for U.S. firms in such situations, because, except for the largest U.S. firms, many U.S. bidders lack the capability to compete for the complete tender. Other posts noted that unless MOU-type proposals were tied to financing, the countries would not be interested.

Another aspect of this definitional problem is whether formal "economic cooperation agreements" and "joint economic commissions" result in exclusionary procurement practices similar to those resulting from Brazil's agreements. Such non-specific government-to-government accords are more common worldwide than the detailed Brazilian type accords. Indeed, the United States has such economic cooperation agreements with numerous countries. The potential trade benefits of cooperative agreements lie in improved U.S. opportunities to gain access to a country's economic planning process and in stated commitments to increase trade levels possibly resulting in allocation of major projects.

Through our questionnaire of U.S. businesses and requests for information from the U.S. Embassies in France, Germany, and Japan, we sought to further identify whether these competitor countries' use of bilateral agreements had the effect of securing export markets. However, the embassies reported virtually no knowledge of other such agreements and U.S. businesses, while reporting that these exist, could provide little concrete information on them.

COMMERCE DEPARTMENT CAUTIOUS  
IN PROMOTING FURTHER MOUS

Despite Commerce's initial interest and stated intention in April 1983 to identify opportunities for using the MOU approach elsewhere in the world, Commerce did not actively pursue this effort following the basically negative responses to its cable inquiry. Commerce also noted certain disadvantages in pursuing such accords more widely. For example, Commerce cautioned that many less developed countries would agree to MOUs only if they included parallel financing provisions for financing local costs or general balance of payments support. Commerce also noted that widespread U.S. use of MOUs might encourage export competitors to sign more explicit and exclusive accords, resulting in the exclusion of U.S. suppliers from important markets and leading to increased subsidization of export financing by other countries. In addition, MOUs would not be necessary or desirable in countries which already follow open bidding procedures and would contradict U.S. government objectives in countries considering signing the GATT government procurement code.

By late 1984 Commerce had scaled back its initial interest in wider use of MOUs in favor of focusing on their success in Brazil and seeking to familiarize the FCS staff in other countries with these accords' possible commercial advantages. Commerce was also not able to identify many other countries practicing exclusionary major-projects procurement similar to Brazil.

Factors favoring success with this approach in Brazil are optimal in terms of the commitment by the U.S. commercial counselor there and the impetus given by the former U.S. ambassador to Brazil to this approach. However, government trade officials remain skeptical about the value and need for the MOU approach. Commerce officials believe that once the energy MOUs with Brazil start to result in actual sales, which should happen by the end of 1985, there will be increased interest in this export technique from other agencies and FCS posts in other countries.

#### MULTILATERAL RULES DO NOT APPLY

The U.S. government seeks to promote an open trading system through multilaterally agreed upon rules; however, the United States has had no basis under existing multilateral rules to complain about our competitors' use of such exclusionary trade accords in Brazil. In fact, such practices are specifically allowed for under Article III of the GATT which states that its rules do not apply to "procurement for governmental agencies of products purchased for governmental purposes." Although our foreign competitors have signed the GATT Government Procurement Code, Brazil, like most developing countries, has not. The U.S. government has sought to persuade Brazil and other countries to sign this code, but Brazil does not appear likely to sign in the near future.

The initial publicity given by the Commerce Department to the U.S.-Brazil bilateral accords appeared to signal, at least in Brazil, a more aggressive U.S. response to competitor practices and a new willingness to pursue bilateral tactics.

The U.S. government's recent, more cautious approach to promoting further MOUs with other countries not subject to the Code may have lessened the thrust of this bilateral policy initiative and, in our opinion, does leave a somewhat unclear impression as to what aggressive bilateral tactics the United States is willing to pursue.

#### U.S. BUSINESS PERCEPTIONS OF THE USE OF GOVERNMENT-TO-GOVERNMENT ACCORDS

Through our questionnaire we queried industry about their knowledge of the use of government-to-government accords in Brazil and world-wide and how they may be affecting their export opportunities. In the Brazilian market the majority of respondents did not know if France, Japan, and West Germany were using bilateral trade accords which reduced their ability to compete in the Brazilian market, or in other world markets. Of the

firms that were cognizant of their competitors' bilateral accords in Brazil, about 62 percent, however, did feel that such accords have been reducing their ability to compete at least to some extent.

Of those firms that believed their competitors' bilateral trade accords were restricting their ability to compete worldwide, France was cited most often (by 14 of 50 U.S. firms). Japan's bilateral accords were cited by 9 of 48 U.S. firms, while Germany was cited by only 3 firms. The greater use of bilateral trade accords by France may be explained, in part, by its long colonial history in certain regions of the world. Cultural, linguistic, political, and economic similarities which resulted from these relationships lend themselves to bilateral trade accords. Perhaps the best example of this relationship is between France and certain countries in West Africa, which was cited by several U.S. firms as being a closed market for the French.

We tried to determine how the U.S. firms would react to wider use of U.S. government-to-government accords, in part, to counteract foreign government involvement. Half of the 69 percent of firms expressing an opinion felt that the U.S. government should expand its use of government-to-government accords worldwide to a great extent or to a very great extent. All firms responding felt that they should be used at least to some extent.

#### AGENCY COMMENTS AND GAO RESPONSE

With respect to the MOUs, Commerce, State, and the U.S. Trade Representative noted that the report overstates their significance as a trade policy tool. We made it clear, however, that to date, the MOUs cover only certain products and projects. Commerce did state that MOUs have been used effectively in Brazil and could have application in other countries, and it also noted that until the U.S. government countered with its own MOUs, our European competitors were the principal beneficiaries of Brazil's policy.

The Commerce Department has highly publicized the MOUs as an export promotion tool. They were signed in April 1983 by the Deputy Secretary of Commerce, were featured as the May 2, 1983, cover story of Commerce's Business America publication, were reported on in subsequent issues including an article showing the Secretary of State presiding over the signing of preliminary contracts, and were promoted to U.S. businessmen at a special seminar describing the commercial opportunities they offer. Also, the Deputy Secretary of Commerce was reported in the U.S. press (Business Week, May 2, 1983) as characterizing the MOUs as a major breakthrough in U.S. trade policy and as setting the

stage for similar agreements with other countries. Furthermore, as noted in this chapter, Commerce requested 28 Foreign Commercial Service posts to report on the advisability of initiating other bilateral talks on MOUs. We would have expected that Commerce by now might have developed more complete information as to the use of such techniques in the world trading community that provide foreign firms with a competitive advantage over U.S. firms.

Commerce also stated in its comments that the U.S. government should focus more attention on directly addressing Brazilian restrictions than on adapting ourselves to these restrictions. State also pointed out that the MOUs are not legally binding instruments, as are bilateral and multilateral agreements.

We agree with Commerce that it is preferable to directly address a country's restrictive trade practices; however, when such efforts make little progress, such initiatives as MOUs in Brazil can be desirable in promoting U.S. firms' competitiveness. Such agreements would hopefully, at some point in time, be superseded by country actions terminating restrictive trade practices. The responses to our questionnaire show that the U.S. business community is generally supportive of such U.S. government initiatives.

## CHAPTER 3

### COUNTERTRADE: A GROWING PHENOMENON

Once isolated to trade dealings with Eastern bloc countries, countertrade now appears to be a small but growing, phenomenon in numerous developing nations.<sup>1</sup> Currently estimated at anywhere from 1 to 40 percent of world trade, the extent of global countertrade is a source of much dissension among trade experts, as is the question of whether it is merely a temporary aberration or is becoming a long-term, institutionalized trading tactic. Consensus exists, however, on one major point--that at least for the near term, countertrade demands, strategies, and deals-in-progress are on the rise.

While countertrade offers both advantages and disadvantages, many countries, like Brazil, find the concept attractive as a potential way around the problem of foreign exchange scarcity. Like other developing countries troubled by illiquidity, Brazil has sought answers to the paradox of adhering to the International Monetary Fund's stringent guidelines to cut imports and increase exports, while also sustaining the imports needed as components to produce goods for export and for general consumption. To such countries, countertrade can seem to provide a means to obtain necessary, albeit hard to get imports without the outflow of scarce foreign exchange and with the additional bonus of guaranteed export markets. Not surprisingly, Brazil, along with other Latin American countries like Columbia and Mexico, has already initiated various countertrade programs. Our review showed that, in choosing among exporters vying for its import markets, Brazil considers the willingness to countertrade a significant competitive factor in certain market sectors.

Although countertrade threatens an open, non-discriminatory multilateral trading system by foreclosing market sectors from competition based on price and quality, its use is not governed by international law. Countertrade is not prohibited under the GATT nor under U.S. law. Like most developed countries, the United States does not attempt to regulate countertrade, choosing instead to remain neutral on the issue of strictly commercial countertrade--allowing firms to decide for themselves whether or not to engage in this trading practice--while still maintaining a stated opposition to countertrade that is governmentally mandated.

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<sup>1</sup>The International Trade Commission has identified over 100 nations which have participated in some form of countertrade.

Despite the absence of comprehensive government guidelines regarding private countertrade, U.S. business seems to be in the process of gearing up for its continued use as a potentially necessary means to maintain trade with developing nations.

DEFINITIONS AND STUDIES OF COUNTERTRADE  
ARE NUMEROUS AND OFTEN CONTRADICTIONARY

Often thought of as merely barter, or trade without money, the term countertrade actually encompasses an array of trade practices which do involve some monetary exchange. Broadly stated, a countertrade transaction sets up a linkage between the buyer and the seller, obliging the seller to purchase certain goods from the buyer in order to offset the price of the original sale.

Disagreement as to definitions of countertrade leads to differences in the amount of world trade attributed to it--current estimates range from 1 to 40 percent. The large variance is due to both the lack of hard data on countertrade deals and inclusion or exclusion of certain trade practices in the measurement of how much countertrade is taking place globally. Studies initiated by the Organization for Economic Cooperation and Development (OECD) and GATT, along with the Departments of State and Commerce, have all acknowledged that countertrade appears to be a phenomenon that will increase, at least over the short term.

Countertrade definitions

There are at least small variations--and often large discrepancies--in what practices fall under the general category of countertrade. In major studies and papers on the subject, the range includes everything from mere barter trade to inclusion of all bilateral arrangements.

Because our study focuses on commercial trading practices, the following specific practices have been included under our use of the term countertrade:

1. BARTER. A one-time exchange of goods or services without the introduction of any cash payment, arranged under one contract.
2. COUNTERPURCHASE (or indirect compensation). Seller agrees to buy back something from the original buyer or another entity equaling the full or partial value of the initial sale.
3. BUY-BACK COMPENSATION (or direct compensation). Seller of machinery, technology or

goods produced from the purchased equipment or technology.

4. **OFFSET.** Supplier agrees to market products produced in the buyer's country or to allow some portion of the goods sold (often military hardware) to be manufactured in the buying country to "offset" the price of the original goods.
5. **SWITCH TRADING.** A third party (or series of participants) is brought into countertrade transaction to accept the countertrade obligation of the original seller.

These five forms of countertrade tend to be made on a private, contractual basis.

Some trade experts also include governmentally sponsored trade arrangements under the heading of countertrade since they result in restricted trade flows and can be thought of as systematized forms of barter.

6. **BILATERAL TRADE ARRANGEMENT.** Two nations agree officially to exchange goods over a specified period of time; exports are paid for in domestic currencies through central banks.
7. **MULTILATERAL CLEARING SYSTEM.** Accounts are maintained with each participating nation's central bank, to enable the exchange of a set volume of goods (often on a regional basis); settlements of trade imbalances are made in cash at standard points in time (e.g., quarterly).
8. **EVIDENCE ACCOUNT.** A government entity of a developing country and a western firm set up an umbrella trade agreement which serves to facilitate and document trade flows (often used when countertrade is a national requirement); trade must be balanced over a specified period.

One conceptually useful way to define countertrade is to divide it between the categories of "commercial" versus "industrial" countertrade transactions. Commercial countertrade would entail traditional arrangements generally used to overcome foreign exchange constraints--normally short-term exchanges of surplus commodities for essential imports involving current production and generally limited amounts of goods (i.e., less than \$10 million). Barter, counterpurchase, switch trades, along

with bilateral trade and multilateral clearing arrangements, would fall under this category. Industrial countertrade would involve longer term arrangements to implement industrial policies and export expansion programs--entailing exchanges of technology, manufacturing capability, etc., for the resultant output. This form of countertrade necessitates plant involvement for future production and major capital outlays. Offsets, buy-back compensation, and coproduction would be in this category.

It is important to note that whereas commercial countertrade may have relatively little impact on world trade, industrial countertrade may have major ramifications, because it involves long-term structural changes in trading relationships. This is believed to be the form of countertrade that is having the most international growth.

Studies have not determined the effects of countertrade on either U.S. industry or LDC economies

Despite a growing interest and concern regarding the effects of countertrade, no well-documented analysis is currently available on the actual effects of the practice on either the U.S. industrial base or economies of LDCs. Numerous studies have attempted to define the issues surrounding countertrade, but none to date have anything but broad estimates on the amount of countertrade occurring globally. For example, a recent GATT study cites estimates that countertrade may account for anywhere from 1 to 40 percent of overall world trade, and defines countertrade only as ad hoc forms of barter. Similarly, an OECD study group has not been able to determine the exact level of countertrade occurring globally. Both the GATT and OECD study groups believe that countertrade, in its various forms, can have major negative effects on both the world trading system and individual trade partners.

Numerous U.S. agencies have initiated countertrade studies but none have definitively established its impact on U.S. industry. The U.S. Trade Representative has chaired an inter-agency Trade Policy Review Group study on countertrade and barter, which remains the most official, but still unclear, statement of U.S. policy--making recommendations which condemn countertrade in principle while not opposing it as a business practice. The Departments of Commerce, Treasury, and State have issued countertrade studies, as well as the International Trade Commission, which is currently involved in a major assessment of the effects of countertrade on U.S. industry due for release in mid-1985. Studies by private business groups tend to show higher estimates of countertrade than do U.S. government studies.

## THEORETICAL ADVANTAGES AND DISADVANTAGES OF COUNTERTRADE

A major part of the debate over countertrade stems from the lack of knowledge and long-term experience regarding the net effects it has on LDCs, Western firms, and the world trading system. Whether the benefits attributed to countertrade as a trading tactic are real or illusionary is still open to debate.

### Perceived benefits for LDCs

In light of widespread foreign exchange shortages in Latin America, it is not surprising that countertrade, as a potential remedy to trade problems, would seem attractive. Below are some of the benefits attributed to countertrade as broadly defined.

- An alternative means of financing imports when balance-of-payment deficits have produced a shortage of foreign exchange.
- A means of obtaining hard currencies by requiring exporters to purchase from domestic sources or to make new investments in-country.
- A way to improve domestic industries, through buybacks and technology transfer, while securing a buyer for new products.
- The expansion of export markets via the utilization of the developed countries' marketing and distribution network (access to marketing skills and resources often unavailable to LDCs to develop non-traditional exports.)
- The potential to unload surplus goods of poor quality or which have decreasing markets (or increasing international competition).
- The ability to camouflage the price of export goods (for purposes of undercutting cartel prices, disguising dumping, or under-rating tariffs, quotas, etc.)
- A way to circumvent trade impediments such as foreign exchange fluctuations and domestic foreign exchange controls.
- A means to reduce excess demand for foreign exchange without depreciating domestic currency (necessitating a policy change).

- The potential for increased East-South trade with Eastern-bloc countries which often require countertrade.
- The capability to exert some influence over multinational corporations.

Perceived benefits for developed nations

The debt crises in the developing nations have had a strong corresponding effect on the industrialized countries because of resulting large reductions in LDC export markets. Marketing techniques and trading tactics were forced to become more "creative". Countertrade, as well as other "compensatory arrangements" became a mode of trade based on necessity. Some Western trade experts contend that countertrade has had a positive impact on world trade since they believe it can help to maintain trade during periods of financial difficulties when countries often find hard currency scarce. Countertrade can provide the following other possible advantages.

- The opening of new export markets, and maintenance of existing markets, unable or unwilling to do business without some form of countertrade.
- A competitive trade edge over companies/countries that refuse to countertrade.
- A potential sale of related goods, services, spare parts, "package arrangements", and turnkey projects.
- The long-term conditioning of export markets toward a given product line, establishing a pattern of subsequent sales while closing out the competition.
- A political advantage by way of improving economic ties with the developing country and proving reliability as a trading partner.
- The opportunity of establishing secured access to essential raw materials.
- The ability for firms to create new production capacity via compensatory arrangements with an LDC--production/assembly of labor-intensive or older technology products can move to the LDC (at a lower than domestic cost) freeing production space for new product lines.

- A way of understating the true value of the transaction in order to take advantage of tax and tariff laws.

#### Potential disadvantages for LDCs

Countertrade may entail more long term negative effects than are initially realized. LDCs may find that countertrade:

- Can eliminate choice regarding price and quality of goods received in exchange as part of countertrade deals--counter to the principle of comparative advantage.
- May leave domestic manufacturers out-of-touch with the real marketplace allowing the postponement of competitively necessary product line changes.
- May saturate export markets with low-priced goods, driving the prices and profits of LDC goods down further.
- Can also discourage domestic manufacturers from ever developing an international marketing capability by reliance on outside help.
- Requirements may stop some firms from trading in the country making such demands, and thereby limit themselves to imports from firms offering lower quality or older technology products.
- Ties up export earnings involved in specific transactions, therefore limiting flexibility and leverage for other import/export trade.
- Offers only short-term palliative solutions to exchange shortages, which may mask or delay necessary and fundamental economic adjustment policy changes.

#### Potential disadvantages for developed nations

The liabilities incurred from entering into countertrade deals may greatly offset gains. Western firms may conclude that countertrade:

- Can complicate trade negotiations and develop into time-consuming and costly difficulties in culminating a deal.

- Obliges the exporter to become an importer, enduring the inconvenience of repackaging, marketing, and delivering the countertraded goods or the additional costs of hiring an external trading company or developing an in-house countertrade department to sell the goods.
- Entails goods which are often of either low quality, have limited market appeal or have different specifications than are needed for home market distribution.
- Can involve "exporting jobs" which may lead to domestic union problems and political difficulties at home if industrial countertrade practices encourage growth in foreign manufacturing capabilities which then replace U.S. industry.
- Can distort both commodity prices and trade patterns, especially those deals involving offset and coproduction (so-called industrial countertrade).
- May entail technology transfers or other compensatory transactions, which might result in development of a future competitive rival in that market.
- Could result in down-grading of quality if foreign parts are used--if the same trademark is used for both domestic and foreign (compensation) production the reputation of the firm may be jeopardized.

Thus, countertrade can be both an inefficient and expensive way of doing business--undesirable on most counts to Western firms used to competition based on service, quality, and price. However, in the short-term firms may be faced with either offering countertrade or effectively losing that export market.

The benefits of countertrade are often more easily discernable than the liabilities. The full costs of a countertrade deal may not be fully known until the transaction culminates. To an LDC without adequate foreign exchange or to a multinational firm which stands to lose an essential export market, the option not to countertrade may seem foreclosed. The perception of gain, even if only for the short-run, seems to be enough to keep countertrade in existence.

## COUNTERTRADE IN BRAZIL

Reliable data is scarce on countertrade in Brazil, as it is internationally, but present U.S. embassy and industrial source estimates range from 2 to 50 percent of total Brazilian trade, (the high percentage would include bilateral clearing agreements). Government and industry experts expect this figure to rise, due in part to Brazil's continuing desire to conserve foreign exchange combined with the perception of countertrade's usefulness to Brazil's industrial development and export goals. Brazil has been cited as one of the most prominent countries in countertrade, outside of the Eastern bloc, along with Indonesia, Iran, and Mexico.

The Brazilian government remains ambivalent about countertrade. On the one hand, it would encourage countertrade as a means to alleviate balance-of-payments problems, but on the other hand, Brazilian government policy does not formally promote countertrade; simple barter is in fact illegal in Brazil. Brazilian government officials have admitted that although countertrade is not ideal, it is preferable to the constriction of trade, specifically with other countries having similar financial difficulties and foreign exchange scarcities.

Countertrade is recognized as having an important place in Brazil's foreign trade, although the likelihood that Brazil will opt for a mandatory countertrade policy is small. For one thing, the IMF strongly opposes countertrade and barter in Brazil and prefers that the practice be limited, since countertrade does not earn foreign exchange necessary for debt repayment and could potentially harm the Brazilian economy. Ways for countertrade to expand in Brazil include government-run trading companies, bilateral payment agreements, and linkages between import license approvals and export promises.<sup>2</sup>

### Government trading companies

Interbras, Brazil's largest trading company, is a subsidiary of the state-owned oil monopoly of Petrobras. Created in 1976, Interbras' express purpose has been to sell or countertrade Brazilian goods for oil and to expand Brazil's export trade internationally. Interbras reportedly accounts for the majority of Brazil's countertrade. Since oil accounts for about half of Brazil's imports, Brazil's trade policy attempts to link petroleum purchases to Brazilian exports. According to

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<sup>2</sup>Brazil's BEFLEX program currently facilitates the acquisition of import licenses when linked with a corporate commitment to export a greater or equal amount of Brazilian-made goods.

Petrobras officials, this policy is currently being toughened. The director of Brazil's foreign exchange office has likewise stated that Brazil will buy oil solely from countries which offer it credit or will purchase Brazilian products in return. The growth of Interbras has been dramatic--from \$100 million in sales in 1976, sales rose to \$2.87 billion by 1983, accounting for approximately 13 percent of Brazil's exports.

#### Bilateral and multilateral trade arrangements

Brazil is a party to numerous bilateral and multilateral trade arrangements, often entered into as a means to establish and maintain trade flows without the need for foreign exchange.

The Latin American Integration Association (LAIA) is a regional trading arrangement to which Brazil belongs as well as Argentina, Bolivia, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. Such an arrangement can facilitate regional trade, specifically in times of foreign exchange scarcities, since it allows for the settlement and credit of trade flows to be made through special accounts in each country's central bank (accounts are cleared quarterly). Settlements with countries with which Brazil does not have such an agreement must be made with U.S. dollars or other freely usable currencies.

Brazil also has bilateral trade arrangements with a number of Eastern bloc nations, namely the USSR, Bulgaria, Romania, Poland, Czechoslovakia, Hungary, and East Germany, as well as Albania. These countries have historically used countertrade as a means of implementing the exchange of goods on an international basis, and countertrade is a normal factor in East-South trade.

U.S. embassy sources report that slightly more than 3 percent of Brazilian imports and approximately 6 percent of exports took place through these agreements in 1983. The Brazilian government has been wary of increasing trade with Eastern Europe since Brazil currently has a \$2.2 billion surplus of trade with these countries and has had problems in the past obtaining settlements, most notably with Poland. This trade surplus with the Eastern bloc nations is subject to switch-trade dealing where, for instance, Brazil's surplus with Romania can be used to give Brazil cash at a discount when the Romanian goods are sold in another market by a trading company.

The IMF and the Commerce Department report that other individual bilateral agreements have been formed between Brazil and nations such as Saudi Arabia, Nigeria, Iraq, Iran, as well as with Mexico and Venezuela (in addition to the standing regional arrangement with them under LAIA.) The IMF allows these

bilateral trade arrangements if accounts are cleared quarterly.

### Individual countertrade deals

Individual commercial countertrade dealings are perhaps even more difficult to substantiate than systematized, government-sponsored countertrade. Countertrade deals in progress receive publicity in Brazil as elsewhere. However, many reported deals are not consummated or are changed dramatically after the completion of preliminary negotiations. The interest in countertrade as a trading strategy is still quite strong among international businessmen in Brazil despite their acknowledgement that many countertrade deals fall through.

Of the three sectors we studied, we found countertrade to be an important trade method mainly in the aerospace area. Brazil remains most interested in countertrade as a means to obtain essential imports but is also concerned with the ability of its domestic industries to expand and develop technologically. This latter concern strongly affects the Brazilian aircraft industry.

Embraer, Brazil's preeminent aircraft manufacturer, has government support as a primary local firm in an industry with great export potential. French influence on Brazil's helicopter industry, in its partnership with Brazil in Helibras, was reportedly linked with the purchase of planes from Embraer. Embraer is strongly interested in obtaining advanced composite technology needed in the manufacture of some of its newest models and is currently negotiating with a U.S. manufacturer to combine technology transfers, coproduction, and offsets as potential components of a deal.

The Brazilian government has also used its leverage and influence in the purchase of commercial, wide body aircraft. This market has historically been highly competitive, with a very small number of firms in competition. Given this buyers market, purchases of these high-ticket imports are often linked with requests for attractive financing packages as well as countertrade. One Brazilian Presidential Directive<sup>3</sup> stops just short of requiring countertrade via offsets or direct compensation, stating that during the examination of requests to import airplanes, the Commission for Coordination of Civil Aero Transport (COTAC) will take into consideration the inclusion of a compensation clause involving Brazilian national products for airplane purchases.

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<sup>3</sup>This directive is based on Decree Law No. 86.010 of May 15, 1981, and Decree Law No. 89.756 of June 5, 1984, which arranged for COTAC; this directive is also referred to as the COTAC Charter.

This directive has had a strong impact on at least two U.S. firms doing business in Brazil. One manufacturer told us that 6 weeks prior to delivery of the aircraft purchased by a Brazilian airline, a "demand" was received from the Brazilians for a 10 percent offset arrangement; this figure was considered arbitrary since the Directive makes no specific percentage requirement. Currently less than 5 percent of the offset has been satisfied. The entire arrangement is to be completed over a 10-year period and, if actualized, could mean over \$15 million in Brazilian exports linked to the original aircraft purchase.<sup>4</sup> The other firm manufactures aircraft engines, and has established an offset arrangement with the Brazilian Air Ministry which entails use of Brazilian-made components parts, purchased from a manufacturing facility run by the Air Ministry.

Other countertrade deals reported in Brazil include:

--Telecommunications satellites:

Competition for two contracts in 1982, the first to build and the second to launch two Brazilian telecommunication satellites, entailing a 100-percent Brazilian offset requirement that U.S. firms were unwilling to meet. The contract was awarded to a Canadian firm, with a U.S. firm as subcontractor.

--Avionics equipment:

Under a licensing arrangement with a Brazilian firm, the U.S. manufacturer will buy back the finished products contingent on meeting specifications.

--Brazil-Angola Hydroelectric Dam Project:

Promoted as one of the largest countertrade deals to date involving the export of Brazilian contracting services for Angolan oil. The contract is reported to be for \$600 million signed by the Brazilian Minister of Industry and Commerce, the Angolan Minister of Energy and Petroleum, and a Brazilian business representative.

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<sup>4</sup>These Brazilian exports are reported to be aeronautical in nature; the U.S. manufacturer is currently not bound to any particular product line or required to develop new markets for Brazilian goods.

NO MULTILATERAL RULES GOVERN  
THE USE OF COUNTERTRADE

Although most international trade experts agree that countertrade appears to be a retrogressive move toward bilateralism and a challenge to the basic tenets of a free trade system, no like consensus exists on how to deal with the perceived problem of countertrade's global expansion.

The GATT considers only governmental, not private, actions, and countertrade is not specifically mentioned under this set of international agreements. The principles of GATT are based on the proposition that trade should be determined by economic factors rather than government intervention, and strongly supports the concept of non-discrimination. Countertrade, especially that which is spurred by government involvement, would appear counter to the intent of these international principles.

As previously mentioned, both OECD and the Secretariat of the GATT have studied countertrade issues. Yet, neither group condemns all countertrade outright. Despite these studies, most legal questions remain unresolved, since uses of countertrade have not been challenged formally.

Instances of government mandated countertrade have occurred in a number of countries, but since neither GATT nor OECD have formal countertrade provisions, no sanctions could be imposed on the basis of these international agreements.

RESPONSES TO COUNTERTRADE:  
DISCREPANCY BETWEEN POLICY AND PRACTICE

In the absence of international agreements governing countertrade, individual nations are left to tackle the policy issues for themselves. Government responses to countertrade vary worldwide from strong opposition to open support. Most OECD nations formally oppose countertrade and all trade practices not based on standard commercial considerations, since the concept of comparative advantage is jeopardized by this type of arrangement.

Yet, despite doubts as to the global implications of countertrade, nations generally do not impose negative sanctions on their domestic firms using countertrade abroad, at least so long as all domestic laws are maintained. National firms are generally allowed free reign in decisions to countertrade or not, regardless of the stated governmental position on countertrade.

The government of Japan has taken a firm stand against countertrade and seeks to work with other industrialized nations

to deal with its global impact. Although Japan's long established trading companies are well positioned to become global leaders in countertrade, doing so is generally discouraged unless clearly essential to a specific deal, and then the countertrade obligation remains with the company since no official entity exists as a support agency for countertrade. However, Japan has historically utilized compensation agreements as a means of securing the supply of essential raw materials.

France, along with other European nations, has a more pragmatic approach to countertrade. Although the French government maintains an unfavorable view of government mandated countertrade, the realization that major export markets have difficulty in dealing strictly in cash has led to the establishment of a government-sanctioned facility to help private business with countertrade obligations. The Association pour la Compensation des Echanges Commerciaux (ACECO) was formed under the sponsorship of several commercial associations and French banks to facilitate international trade and countertrade deals.<sup>5</sup>

Germany, like France, focuses on the practical realities of marketing products abroad while still supporting the OECD stance against mandated countertrade. Having developed experience in dealing with the countertrade demands of Eastern bloc countries, German firms are often practiced at expediting these transactions. Germany, too, has an organization which reportedly assists national firms with countertrade obligations--the Internationales Zentrum fur Ost-West-Kooperation (IZOWK).<sup>6</sup>

#### U.S. government response

The U.S. government has always strongly supported a liberal multilateral trading system, but its recognition of the realities of global countertrade demands has resulted in an inherently contradictory approach to countertrade that tries to be both pragmatic and idealistic.

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<sup>5</sup>ACECO's sponsors reportedly include the National Council of French Industry, National Federation of Foreign Trade Associations, Paris Chamber of Industry and Commerce and Federation of Industrial Mechanics and Metalworking. Five major banks also participate as sponsors: the Banque Nationale de Paris, Societe Generale, Credit Lyonnais, Banque Francaise du Commerce Exterieur, and Banque du Paris et des Pays-Bas.

<sup>6</sup>IZOWK's sponsors reportedly include the Central Association of German Chambers of Industry and Commerce (DIHT), Confederation of German Industry (BDI), Berlin Chamber of Industry and Commerce, and Berlin Marketing Council (BAO).

The U.S. government is on record as strongly opposed to barter and countertrade when government mandated, and most U.S. agencies have expressed concern that countertrade conflicts with the goal of maintaining a worldwide competitive trading system. The U.S. Treasury Department, particularly the Customs Service, has voiced concern regarding countertrade, specifically in terms of potential violations of U.S. trade laws. Currently, Customs cannot formally track countertraded goods entering the United States, and it contends that undervaluation and discounting of goods is possible.

Several U.S. agencies, however, have programs supportive of countertrade. The Department of Agriculture actually had an ongoing barter program from 1950 to 1973 under Public Law 480, which disposed of surplus commodities in exchange for strategic materials. More recently, the 1982 U.S.-Jamaican Barter Agreements<sup>7</sup> brought the concept of government barter back into discussion. Congressional bills were introduced to reestablish a barter program which could benefit government acquisition programs such as the National Defense Stockpile, but these bills were not enacted and the United States has not initiated further barter contracts to date.

The Department of Commerce has taken an even more pragmatic approach to countertrade, since agency officials acknowledge that it can be a quid pro quo for entry into numerous international markets, and that U.S. businesses may need to use "untraditional" trade mechanisms to be competitive. Since part of Commerce's mission is to promote international commerce through exports, the International Trade Administration provides trade advisory services for private U.S. firms attempting to countertrade abroad.

The USTR is responsible for coordinating trade policy within the U.S. government. In 1983, it chaired an interagency group, called the Trade Policy Review Group, to study countertrade and develop a U.S. government policy. The following six "recommendations" of this group remain the most comprehensive statement of current administration policy.

1. The U.S. government generally views countertrade as contrary to an open, free trading system. However, as a matter of policy, the U.S. government will not oppose U.S. companies' participation in countertrade arrangements unless such action could have a negative impact on national security.

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<sup>7</sup>The U.S.-Jamaica Barter Agreements of 1982 exchanged Jamaican bauxite (combined total of 1.6 million tons) for U.S. nonfat dry milk products and excess stockpile materials.

2. The U.S. government will provide advisory and market intelligence services to U.S. businesses including information on the application of U.S. trade laws to countertrade goods.
3. The U.S. government will continue to review financing for projects containing countertrade/barter on a case-by-case basis, taking account of the distortions caused by these practices.
4. The U.S. government will continue to oppose government-mandated countertrade and will raise these concerns with the relevant governments.
5. The U.S. government will participate in reviews of countertrade in the IMF, OECD and GATT.
6. The U.S. government will exercise caution in the use of its barter authority reserving it for those situations which offer advantages not offered by conventional market operations.

In essence, the U.S. government and governments of other developed countries may view countertrade with disdain, but they are not so adamantly opposed to it that they actively discourage its use. Market forces are currently such as to promote the use of countertrade as a trading tactic, and it seems unlikely that the United States, or any of the OECD nations, will unilaterally seek to terminate this business practice.

U.S. business response:  
anticipation of  
its continued use

U.S. exporters are greatly concerned over the potential erosion of U.S. market share abroad and generally acknowledge the need to develop new trade mechanisms in response. The new rules of world trade--including countertrade and military offsets--are being accepted, if perhaps reluctantly, as today's reality. U.S. firms seem to be showing interest in learning how to compete using these modes of trade.

We queried U.S. firms on the subject of countertrade through our questionnaire, as well as through interviews of representatives of U.S. companies involved in the Brazilian import market, and found a general expectation that countertrade will increase in importance in Brazilian and other world markets. The actual amount of countertrade reported remains quite limited, however, at least in the three sectors we focused on in our study. Slightly more than 7 percent of the questionnaire respondents could claim actual experience in structuring

countertrade transactions in Brazilian markets. The U.S. businessmen we interviewed in Brazil had similar responses--although they had not had much occasion to countertrade themselves, they were generally aware of an increase in countertrade activity around them.

U.S. firms which have participated in countertrade and off-sets in Brazil deemed these tactics key to having acquired the business. No respondents claimed to have self-initiated the countertrade transaction, however, and almost all claimed little or no government assistance in accomplishing the transaction. Little information was available regarding either the actual form of the countertrade deals (e.g., counterpurchase, barter) or the type of goods traded (e.g., raw materials, equipment). Of the few firms which responded with details on how their counter-purchased goods were marketed, most replied that these goods were either consumed internally or marketed in countries other than the United States or Brazil.

With regards to the future importance of countertrade, over three-quarters (77 percent) of the 81 respondents with an opinion believed that countertrade would either somewhat or greatly increase in importance for their firms in the near future (1985-90). (This percentage and the following data do not include respondents with either no opinion or who checked "don't know".)

Regarding perceived governmental attitudes toward countertrade, many firms (66 percent) believed that the U.S. government is neutral concerning commercial countertrade, although roughly 30 percent felt that the United States discourages private countertrade transactions. About 70 percent of the respondents believed that the U.S. government should recognize countertrade as necessary in today's world and work with U.S. business to use it effectively. Only 6 percent thought that the U.S. government should work to eliminate U.S. countertrade with Brazil and other countries.

Foreign government counterparts were generally perceived as more receptive to commercial countertrade. French, German, and Japanese firms are all believed to use countertrade often as an inducement in contract negotiations worldwide. The Japanese were thought to use countertrade to the greatest extent followed closely by the French. Of the roughly 50 percent of respondents claiming knowledge of competitors' practices, the vast majority thought that countertrade was used from a moderate to very great extent by the Japanese (77 percent), the French (75 percent), and the Germans (64 percent) on a worldwide basis. Much less was known about the extent of European or Japanese countertrade transactions in Brazil alone.

U.S. exporters experienced in countertrade reportedly tend to absorb the countertraded goods internally or utilize outside sources of expertise to trade the goods in third markets. Although the amount of countertrade entering the United States is largely unknown, some U.S. trade officials believe that the United States is still in a "honeymoon period" regarding countertrade--a time when most countertrade goods are either readily absorbed by the huge U.S. home market or reasonably easily placed in third markets. This cannot continue indefinitely, however if countertraded goods begin to glut the marketplace.

One major response to the perceived need to develop non-traditional trade mechanisms has been the emergence of corporate trading companies. In the last few years, roughly 100 corporations have set up trading companies, and more are deliberating the need to do likewise. It does not seem likely that these new trade groups will disappear easily even if the LDC financial problems which prompted such innovative trade practices are resolved. Hence, countertrade and other non-traditional trade tactics may become institutionalized forms of trade.

Indications are that countertrade will become an increasingly important issue for U.S. exporters for at least the near term. What the U.S. government's role should be remains uncertain, however. Detailed clarification of U.S. countertrade policy may create inflexibilities harmful to U.S. business concerns, yet uncertainty and limited support for exporters faced with countertrade demands, too, may put them at a disadvantage with foreign competition. If countertrade continues to grow as predicted and if no multilateral consensus can be reached to govern its use, both the U.S. private sector and government need to focus further attention on pragmatic responses to countertrade demands, with specific emphasis on the question of countertrade's long range costs and benefits to U.S. industry.

#### AGENCY COMMENTS AND GAO RESPONSE

Commerce believes that countertrade is not likely to have a significant effect on U.S. exports for Brazil, and State believes that empirical evidence substantiates that countertrade is an economically unsound and inefficient way of doing business. USTR emphasized that the Trade Policy Review Group developed a policy on countertrade in July of 1983; we had included a description of this policy statement in our draft, which now appears, with commentary, on pp. 34 and 35.

There is very little concrete data available as to the benefits and costs of the use of countertrade. We did not attempt to assess the economic soundness of countertrade in this report. We do, however, present some of the perceived potential

advantages and disadvantages of countertrade, although we have no basis to believe it is advantageous or efficient on balance. Trade experts from State, Commerce, OECD, and GATT generally concur that countertrade is a global phenomenon that is expected to increase, at least for the near term.

U.S. embassy officials in Brasilia, from both the State and Commerce Departments, have commented that countertrade can be expected to increase in Brazil at least over the short term. Although Commerce contends that countertrade is unlikely to have a significant effect, we believe that because of the data problems it remains unclear as to the impact countertrade will have on U.S. firms doing business in Brazil or elsewhere. What is apparent, however, is the concern U.S. exporters feel regarding the perception of increasing countertrade demands by developing nations. The recent expansion of in-house trading companies and countertrade consultant services would seem to demonstrate a willingness by U.S. exporters to consider countertrade as a useful trade strategy.

We did not conclude that U.S. exporters were necessarily being hurt by a lack of U.S. government assistance in meeting countertrade demands. We did report that a majority of our questionnaire respondents felt that the government should "work with U.S. business to use it [countertrade] effectively," and that some other developed nations did appear to aid their exporters with their countertrade problems.

## CHAPTER 4

### COMPETITIVENESS IN EXPORT FINANCING

Because of Brazil's severe foreign exchange shortages over the last several years, the kinds of financing offered by countries seeking to export to Brazil have become a crucially important competitive factor.

In the late 1970s and early 1980s, U.S. foreign trade competitors targeted Brazil as an important export market; they supported their exports through their export credit agencies' numerous programs and through acquiescence to Brazil's demands for additional and unrestricted credits. Since late 1982, the height of Brazil's financial crisis, much of the export financing provided by our trade competitors dried up and the United States has taken the initiative in making continued export financing available for Brazil.

The United States, France, West Germany, and Japan are among 22 participants in the OECD Arrangement on Guidelines for Officially Supported Export Credits, the principal multilateral accord governing officially supported export financing. This Arrangement stipulates minimum interest rates and down payments and maximum credit terms for export financing with repayment terms greater than 2 years. It does not specify financing terms for exports of aircraft, nuclear power plants, or ships which come under separate agreements or for agricultural commodities.

Within the OECD, the United States has consistently sought to reduce the subsidy element in official export credits and to limit the combination of export credits with low-interest foreign aid funds, known as mixed credits, for primarily commercial objectives. The U.S. government has been successful in reducing the subsidy element in recent years, but not in discouraging foreign competitors from using mixed credits, although progress has been made in tightening the rules governing their use. In addition, little progress has been made to include under the arrangement certain competitive financing tactics, such as parallel financing<sup>1</sup> and leasing, used in Brazil and elsewhere to maintain or gain position.

Overall U.S. business perceptions of Eximbank competitiveness and the OECD Arrangement's effectiveness are negative, and many businesses appear so skeptical of U.S. government concern over their lack of competitiveness in export financing that they often do not report other countries' financing practices which they believe to be contrary to the OECD Arrangement.

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<sup>1</sup>Parallel financing refers to the provision of separate, private commercial credit in addition to project financing.

COMPARISON OF OFFICIAL GOVERNMENT  
EXPORT FINANCING PRACTICES

In the several years before Brazil's financial problems reached the crisis stage in late 1982, competitor governments seeking to win sales there pursued more aggressive export financing programs than did Eximbank. During 1982 and 1983, however, competitor medium- and long-term export financing for Brazil virtually dried up, and it was the U.S. Eximbank which led in making available continued export financing. In 1984 and early 1985, however, aggressive competitor financing, particularly by France, has reappeared.

Eximbank lagged in amounts and  
types of financing for Brazil

U.S. trade competitors made available to Brazil in the period 1979 to 1983 greater amounts of long-term financing and a wider range of official export credit programs than did the U.S. government. Table 4 shows the amounts of long-term financing provided to Brazil both in dollar amounts and as a percentage of each country's total long-term export financing. The United States ranks third in total long-term credits provided to Brazil over the 1979-83 period and last as a percentage of worldwide direct long-term loan credits.

Table 4

Long-term Direct Credit Financing  
(1979-83)

<u>Provider Country</u>	<u>For Brazil (in (\$ 000's))</u>	<u>Total Worldwide (in (\$)000's)</u>	<u>Brazil as percent of Worldwide</u>
France	\$2,086.3	\$23,447.0	8.9
Germany	1,531.5	19,032.5	8.0
United States	1,347.1	29,013.0	4.6
Japan	837.7	15,679.3	5.3

Source: OECD statistics, supplied by member countries, as provided by Eximbank.

In addition to basic interest rate and credit risk support, foreign competitors generally offer a wide range of export support programs that the United States by a substantial margin does not match. We were not able to determine which of these programs have actually been used in Brazil, since the OECD does

not receive this information from export credit agencies. The main types of such extraordinary support are

- inflation risk insurance, which protects exporters against losses resulting from domestic cost increases for projects or equipment with lengthy fabrication periods.
- mixed credits, which combine government foreign aid funds with official export credits to produce concessional financing packages.
- local cost support, which involves credit or guarantee support for costs incurred in the purchasing country that are associated with the export transaction.

Another important difference between U.S. Eximbank and other export financing agencies is that Eximbank is reluctant to approve lines of direct credit for countries or borrowers, whereas France and Japan commonly do this. Instead, Eximbank responds to requests for preliminary commitments for sales of individual items. Eximbank noted that it does provide lines of credit for specific projects and that the Europeans have not been competitive with the United States in this area.

Eximbank also noted that several countries which provided inflation risk insurance have now phased it out and added that the best way to help exporters concerned about inflation is to control inflation, as it states this Administration has done. Eximbank also noted that it will provide local cost guarantees when convinced that the competitive situation and the nature of the project make such support appropriate.

Mixed credits dry up in Brazil  
but increase elsewhere

Mixed credits in particular have been actively used by U.S. trade competitors to win exports around the world, and until recently Brazil was a key recipient of such mixed credits. For example, according to OECD figures on reported mixed credits, Brazil was the second largest recipient of mixed credit offers from January 1980 to September 1983, but these dried up rapidly in 1983. (See table 5.)

Table 5

Mixed Credit Offers Shown According to OECD Country Classifications

Top 18 Recipient Countries  
Jan. 1, 1980 - Sept. 26, 1983

<u>Country<sup>b/</sup></u>	<u>No of mixed credit offers included</u>	<u>Category II</u> ( <u>"Intermediate"</u> ) Countries	<u>Category III</u> ( <u>"Relatively poor"</u> ) Countries	<u>Total no. of mixed credit offers reported</u>
	<u>in \$ amount shown</u>			
Mexico	7	\$1,342.90		9
Brazil	10	1,189.50		13
Egypt	21		930.02	34
Morocco	8	767.54		10
Indonesia	17		602.88	21
India	6		474.33	13
Algeria	3	288.55		7
Columbia	4	284.13		6
Burma	10		165.82	13
Jordan	3	156.60		5
Malaysia	4	147.43		7
Turkey	5	137.89		8
Tunisia	8	130.29		17
Kenya	4		128.8	5
Philippines	5		120.88	8
Peru	5	112.87		5
Zimbabwe	4		65.48	10
Thailand	<u>3</u>		<u>24.52</u>	<u>3</u>
TOTAL	127	\$4,557.70	\$2,512.91	194
	=====	=====	=====	=====

Top 15 Recipient Countries  
Jan. 1, 1983 - Dec. 31, 1983

<u>Country</u>	<u>No of Mixed Offers Included in \$ Amount Shown</u>	<u>Category II ("Intermediate") countries</u>	<u>Category III ("Relatively Poor") countries</u>	<u>Total No. of Mixed Credit Offers Reported</u>
		(millions)		
India	5		\$ 395.31	10
Indonesia	15		327.73	22
Morocco	5	299.80		6
Algeria	1	220.90		4
Egypt	15		219.49	21
China	3		186.48	4
Colombia	2	173.63		4
Malaysia	1	141.46		3
Thailand	5		95.45	5
Cameroon	3		78.73	3
Tunisia	3	70.19		7
Zimbabwe	7		65.76	8
Zaire	4		63.14	4
Pakistan	4		62.11	5
Philippines	3		52.60	5
TOTALS	76	\$ 905.98	\$1,546.80	111
	***	*****	*****	***

<sup>a</sup>Insufficient reporting of mixed credit offers would mean these totals are understated. On the other hand, as Eximbank noted in its comments on this report, in many cases, two or more countries have offered funds for the same project, so addition of all offers may overstate the magnitude of trade distortion caused by mixed credits.

<sup>b</sup>Eximbank is active in 17 of the 18 countries. Burma is the exception.

We were not able to obtain information on each competitor's mixed credits specifically for Brazil, but their overall use of mixed credits is shown in table 6. France makes the greatest use of mixed credits, accounting for about 58 percent of the dollar value of reported mixed credits during 1980-83. The dollar value of its mixed credits in 1983 alone was \$1.3 billion. Germany and Japan are the second and third largest providers of mixed credits, accounting for 11 percent and 9 percent, of the total dollar value reported to the OECD.

These figures understate Japan's use of mixed credits because the Japanese, due to differing financing mechanisms, do not report most concessional financing cases as tied aid or mixed credits. In addition, the Japan's aid agency (the Overseas Economic Cooperation Fund) has discretionary authority over the Japanese export-import bank as to which funds are to be mixed; thus Japan's bank does not have the power to restrict mixed credits. In 1981 the Overseas Economic Cooperation Fund targeted \$1.9 billion of its budget to match mixed credit offers, particularly from France, and for exports of industrial machinery and turnkey projects.

Table 6

Reported Mixed Credits by Donor Country  
January 1, 1980 - December 31, 1983  
Based on OECD Information Exchange Data<sup>a</sup>  
(\$ millions)

Donor Country	1980		1981		1982		1983		Totals		
	Dollar Value	# of Offers	Dollar Value	% of Total	# of Offers						
Australia	---	---	---	---	---	---	---	3	---	---	3
Austria	217.74	9	127.60	7	49.30	1	306.56	5	701.20	7.10	22
Belgium	---	---	---	---	31.30	6	52.18	26	83.48	.84	32
Canada	---	---	150.00	1	---	---	65.16	4	215.16	2.18	5
Denmark	---	---	---	---	---	1	5.17	1	5.17	.05	2
Finland	---	---	---	---	---	3	---	1	---	---	4
France	1,768.44	15	1,000.30	11	1,664.48	32	1,278.16	39	5,711.38	57.84	97
Germany	10.28	2	1.90	1	215.65	11	836.23	35	1,064.07	10.78	49
Italy	24.18	4	---	---	161.80	14	284.85	23	470.83	4.77	41
Japan	---	---	848.00	2	---	---	---	5	848.00	8.59	7
Nether.	25.02	1	27.40	1	46.67	15	171.26	34	270.35	2.74	51
Spain	101.60	4	---	3	---	---	---	1	101.60	1.03	8
Sweden	---	---	---	13	72.90	11	6.28	23	79.18	.80	47
U.K.	---	2	---	6	101.70	8	221.71	19	323.40	3.28	35
<b>TOTALS</b>	<b>2,147.26</b>	<b>37</b>	<b>2,155.20</b>	<b>45</b>	<b>2,343.80</b>	<b>102</b>	<b>3,227.56</b>	<b>219</b>	<b>9,873.82</b>	<b>100.00</b>	<b>403</b>

<sup>a</sup>In many cases, two or more countries have offered funds for the same project, so addition of all offers may overstate the magnitude of trade distortion caused by mixed credits. On the other hand, insufficient reporting of mixed credit offers would mean these totals are understated.

Source: Export Import Bank

The U.S. government has long opposed other countries' use of mixed credits to win exports. Due to the lack of progress within the OECD toward reducing the use of mixed credits, Congress in the Trade and Development Enhancement Act of 1983 directed that Eximbank and the Agency for International Development jointly establish and coordinate a mixed credit program for U.S.

Japan's Eximbank was basically closed to Brazil as of late-1983.

The U.S. Eximbank on the other hand announced in August 1983 a \$1.5 billion facility for medium-term guarantees and short- and medium-term insurance to facilitate current U.S. exports to Brazil, to bolster confidence in Brazil's economy, and to bridge a portion of the \$9 billion to 10 billion balance-of-payments gap expected in 1983-84. The facility was intended to enable U.S. commercial banks to establish lines of credit over a year-long period with Brazilian institutions to finance individual U.S. exports. Purchasers in Brazil would then be able to place orders for U.S. goods and services with the knowledge that a reliable source of financing was already in place. Exports expected to be covered by this facility are industrial and agricultural goods and services.

At the time this facility was approved, the prospects for U.S. exports to Brazil appeared bleak. U.S. exports to Brazil had fallen by 30 percent in the first half of 1983, following moderate declines in 1981 and 1982, and it was projected that 1983 U.S. exports would be almost 50 percent below 1980 levels.

Usually U.S. Eximbank loan guarantees are made for specific transactions and are tied to specific projects, although Eximbank notes that it has made such broad authority guarantees before. What is considered unusual about the facility are the amounts involved--the largest single package ever proposed by Eximbank--and the conditions attached to their use -- that (1) Brazil comply with the International Monetary Fund stabilization program, (2) commercial banks establish an additional financial program for Brazil, and (3) other creditor nations make commitments to provide comparable financial support. The third condition was attached to assure equitable sharing of the financing burden among creditor governments. The Treasury Department calculated that an equitable U.S. share should amount to about 40 percent.

We attempted to learn what commitments were actually made by creditor governments and whether they really are comparable, but other creditors have not provided this information to the U.S. government. Although such commitments are a condition precedent to the implementation of the \$1.5-billion facility, the United States has simply been assured that commitments have been made.

Even informally, little was known within the U.S. government about these commitments. Clearly, other creditor governments did not publicize them as Eximbank publicized its \$1.5 billion special facility. After Brazilian President Figueredo's visit to Japan in May 1984, the Japanese government

did inform Eximbank that it approved a 23 billion yen (about \$100 million) line of credit to Brazil in June 1984. The German and French export credit agencies were reported to be providing short-and medium-term credit on standard terms, on a case-by-case basis, but were not known to be offering anything extraordinary.

#### OTHER FINANCING TACTICS

While competitiveness in official export financing support is of prime concern to U.S exporters and the U.S. government, there are several facets to the larger picture of export financing competitiveness in Brazil. A few years ago, the ability and willingness of export competitors to provide separate and additional parallel financing had been an important competitive factor. Recently, Brazil has also shown increased interest in leasing rather than buying in order to improve its balance-of-trade statistics, and exporter ability and willingness to lease may prove a competitive advantage now.

#### Parallel financing

In response to its accelerating balance-of-payments deficits, Brazil developed a policy to obtain parallel commercial bank financing at least equal to, and in some cases up to double, the financing it requested for specific projects. In effect, foreign firms bidding on major capital projects in Brazil were required not only to arrange 100 percent of the project financing, but in addition to arrange parallel financing ranging from 100 to 200 percent of the supplier credits. Export competitor willingness to acquiesce in Brazil's demands for such parallel credits thus became an important competitive factor. This Brazilian tactic was more successful a few years ago, when trade competitors in vying for export opportunities in Brazil were willing to sweeten their financial offers by financing unspecified local costs in addition to the actual imports.

One example of such Brazilian interest in parallel financing arose in connection with the proposed purchase by a Brazilian government-owned airline of several Airbuses. The Brazilians sought to make the purchase of the Airbuses conditional on European banks' supplying a multi-million dollar loan to finance airport construction and ground avionics purchases. The Europeans' willingness to provide such parallel financing was considered by U.S. government officials to be a key selling point for Airbus.

Although Brazil's aircraft purchase in this instance was postponed indefinitely, the case does illustrate the type of challenge posed for the U.S. exporter and for U.S. government trade policy. The centralized coordination of official export

credit and commercial bank lending that can be arranged in a country such as France, where much of the banking sector is nationalized, is not possible under the U.S. economic system. A USTR official noted that the U.S. government could not have invoked the GATT Aircraft Code prohibition against "inducements" to purchase because it was Brazil's initiative to press for such parallel financing and Brazil is not a signator of the GATT Aircraft Code.<sup>2</sup> Participants in the OECD Export Credit Arrangement do not currently agree that such untied financing falls under the mixed credit definition, although the U.S. government is seeking to clarify this definition to include parallel credits.

Although the practice of providing parallel credits has not been used very frequently in Brazil recently, it is now reported to be an important competitive financing factor elsewhere in the world.

### Leasing

Another financing tactic of increased interest now to Brazil is leasing, because IMF financing conditions focus on improving Brazil's trade balance, and the IMF does not require leased equipment to be recorded as an import in Brazil's balance of trade, as long as the lease contract covers less than 75 percent of the cost of the asset. Such cross-border leasing also offers other advantages to countries where capital is in short supply, such as the absence of large, front-end deposits, allowing increased cash flow; varied lease payments and terms according to revenue expectations; deferral or elimination of customs duties; and preservation of existing credit lines with banks.

We encountered reports of recent Brazilian interest in leasing such moveable items as commercial aircraft and oil drilling rigs, and at least one U.S. bank in Brazil is specializing in leasing. Systematic information on the leasing activities in Brazil of the United States and its competitors was not available, however.

According to a 1984 Eximbank study, the U.S. equipment leasing industry reportedly holds 75 percent of the world cross-border leasing market, a market estimated to have doubled between 1975 and 1980 and predicted to grow by another 33 percent by 1985. The study also notes that the most important foreign markets for U.S. leasing firms are Europe, Brazil, Canada, Korea, and Mexico.

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<sup>2</sup>Signatories of this Agreement are the United States, Canada, the European Economic Community and its member states, Japan, Norway, Sweden, Switzerland, Austria, Egypt, Greece, and Romania.

Little concrete information about foreign competitors' leasing practices is available, though it is generally agreed that competitors' interest and use of leasing is growing. U.S., French, and German export credit programs for leasing are basically similar in several respects, although the French export credit agency's coverage is considered slightly broader than Eximbank's. The Japanese have also shown interest in developing new types of leases to meet growing demand.

#### PROGRESS IN IMPROVING MULTILATERAL FINANCING GUIDELINES

Negotiations among major exporting nations within the OECD to reduce export credit subsidies began in 1973 and resulted in 1978 in agreement on "The Arrangement on Guidelines for Officially Supported Export Credits." The Arrangement seeks to ensure fair credit competition on most exports from OECD nations by setting interest rate floors, ceilings on maturities, minimum down payments, and maximum local cost financing.

Some OECD participants, however, have been more willing to tolerate the costs of interest subsidization than the Eximbank has been. U.S. negotiators have persistently led efforts within the OECD to reduce costly export credit competition and by April 1985 had accomplished the following major objectives:

- Virtual elimination of subsidy aspects from medium-term export credit programs of all major competitors except France.
- Reclassification in July 1982 of 36 countries, including Brazil, from the "relatively poor" to the "intermediate" category, with the effect that the minimum arrangement interest rate on long-term loans for this group rose from 7.75 percent before November 1981 to 11.35 percent by January 1983. (Twelve countries were graduated to the "relatively rich" category, and 72 countries were left in the "relatively poor" category.)
- Introduction in October 1983 of automatic adjustment of minimum interest rates every 6 months to better reflect average world market rates.
- Increase in 1982 in the minimum grant element of mixed credits from 15 to 20 percent and the requirement for prior notice of grant elements in the 20 to 25 percent range.

--Increase in April 1985 in the minimum grant element from 20 to 25 percent; requirement of prior notice for grant elements up to 50 percent; and lengthening the waiting period (from 10 calendar to 20 working days) prescribed for matching purposes.

### Mixed credits persist

The use of mixed credits, however, has persisted and indeed grown as a competitive factor believed to disadvantage U.S. exports. France originated this practice, and other countries have since developed mixed credit programs.

In negotiations at the OECD, the U.S. government has sought a higher floor on the degree of concessionality of the mixed credit package, so as to force the donor to make the offer more generous to the developing country and more costly to itself. But until April 1985 progress had stalemated in the OECD due to sharp disagreement over the desirability of mixed credits. France in particular maintains that mixed credits have positive effects by increasing the financing available to developing countries. The U.S. response is that mixed credits, when used, should be reserved for the poorest group of countries, rather than for the more advanced developing countries. In April 1985, however, OECD members agreed not to offer mixed credits with grant elements representing less than 25 percent of the package. They also agreed to a study, to be completed by September 30, 1985, addressing other ways to restrict trade-distorting credits.

A key point of contention between the United States and its competitors regards the definition of what can be considered a development project. France, Germany, and Japan do not have as sharply defined and targeted foreign aid programs as the United States does, with its focus on basic human needs. Although the United States contends that telecommunications and aircraft projects, for example, are not primarily development projects, there is no accepted international definition of what qualifies as a development project. The developing countries, for their part, are likely to accept the best financing terms, whether or not these are officially termed development projects. The OECD does not have such a definition and has not pressed for multilateral agreement on such a politically sensitive national policy. Thus, there is little prospect for approaching the mixed credit problem by more closely defining what can be considered development financing.

The purpose of the current Eximbank mixed credit program is to discourage the use of mixed credits by selectively matching other credit agencies' mixed credit offers. A previous U.S.

government attempt in 1979-80 to do the same, however, was not fully pursued, due to the large costs involved in matching offers and to the greater priority given at the time to reducing interest subsidies. Although Eximbank did successfully match a few mixed-credit offers of the French, this short-lived effort did not result in a decrease of mixed-credit offers and in our opinion may have damaged the credibility of the U.S. government's present commitment in terms of our competitors' perceptions of Eximbank's consistent willingness to incur the costs of its credit-matching efforts.

Furthermore, the Administration and Congress are reviewing the direct credit program and it is uncertain whether it will be continued. In our opinion, this uncertainty can only leave our competitors more doubtful about the seriousness of the U.S. commitment to its mixed credit matching effort.

#### Parallel credits not covered by OECD Arrangement

Participants in the OECD Arrangement do not currently agree that such untied financing falls under the mixed credit definition, although the United States has sought to clarify this definition to include parallel financing.

#### Vague coverage of leasing

OECD Arrangement guidelines do not specifically cover leasing practices, and any mention of leasing is vague and incomplete. Eximbank, however, wants to be cautious about proposing changes in this area because of the presently strong position of U.S. firms involved in leasing.

#### BUSINESS PERCEPTIONS OF U.S. EXPORT FINANCING

We broadened our questionnaire analysis of official export financing to South America, as a whole, because of recently limited loan activity undertaken in Brazil, and we asked a series of questions regarding both the success of the OECD Arrangement in limiting trade distorting export credits and the competitiveness of the U.S. Eximbank.

We found that many of the firms responding were not even familiar with the OECD Arrangement, with 61 percent having little or no knowledge of it. And while familiarity with the Arrangement tended to be higher among the larger exporting firms, 47 percent of those firms exporting at least \$200 million in 1983 had little or no knowledge of it.

To determine the firms' views as to the success of the Arrangement it was necessary to reduce the universe by the firms

who were not familiar with it or had no basis to judge its success. Once this was done, 27 firms were able to answer the question. Over half of these firms believe the Arrangement was either unsuccessful or very unsuccessful; and only one firm considered it successful. Similarly, over half rated U.S. government steps to guarantee that competitors were living up to their OECD obligations in South America as either ineffective or very ineffective.

Four of 16 firms believed that France was not complying with the Arrangement while 8 felt that there was only partial compliance. A somewhat greater percent of firms believed that Japan and West Germany were abiding by the Arrangement. All 3 countries, however, were cited by 47 percent as using longer than allowable repayment periods and by 55 percent as using lower than allowable interest rates.

Despite their dissatisfaction with the Arrangement, only 6 of 25 firms ever bothered to complain formally to the U.S. government. The other firms cited such problems as the lack of concrete information or the expectation that the U.S. government would not do anything as reasons for not complaining. An analysis of the results of formal complaints to the U.S. government demonstrated that such skepticism about bringing the matter to the attention of the government may not be warranted. In only one of six cases did a firm say that the government did nothing. In three cases either the information was too late or incomplete. Finally, in two of the six cases formal complaints did make a difference. In the first case, Eximbank came through with the financing terms enabling the firm to compete successfully. In the second case, the competitor government amended its financing terms to abide by the Arrangement after a complaint was lodged by the U.S. government.

Aside from the perceived failure of the OECD Arrangement to control predatory export financing in South America, many U.S. firms contend that Eximbank credit terms often do not allow them to be competitive with other overseas suppliers. For example, 46 percent of responding firms contend that they have lost contracts in South America largely due to Eximbank's failure to match the rates and terms offered by competitor country institutions. Uncompetitive interest rates and repayment periods were cited by 86 percent and 51 percent of the firms, respectively, followed in order of importance by uncompetitive local cost financing and foreign use of mixed credits. Financing through parallel credits, for transactions unrelated to the officially supplied credit, was cited by 14 percent of the firms.

Our questionnaire results also showed that in order to circumvent what many U.S. firms believe to be uncompetitive

U.S. financing, a number of firms have been exporting to South America from their foreign subsidiaries. In 1982 and 1983, 22 and 23 percent of our respondents made sales to South America from their foreign subsidiaries, primarily because more competitive financing was provided in the countries where their subsidiaries were located. The total dollar value of their foreign-sourced exports amounted to over \$483 million in 1982 and 1983.

#### AGENCY COMMENTS AND GAO RESPONSE

Eximbank provided updated information on the April 1985 OECD directives strengthening discipline and transparency in the use of mixed credits. It stated its belief that even tighter restrictions on mixed credits can be negotiated in the coming months, and it noted that in past negotiations among OECD countries it has succeeded best when it used an array of tactics, both diverse and unpredictable, which did not include adopting the system it wanted our competitors to discontinue. Eximbank also noted inaccuracies in some of the criticisms of its programs expressed by U.S. firms responding to our questionnaire. In particular, Eximbank noted that many firms seem not to know that it does provide competitive financing directly or through commercial banks or to be aware of its new Medium Term Credit and Engineering Multipliers programs. (See app. III.)

Commerce disagreed with what it felt to be the report's characterization of Eximbank programs for Brazil as uncompetitive, especially in view of recent examples where it states the Bank has offered aggressive financing. State felt the report is advocating softer mixed credit financing at a time when the role of Eximbank is in flux and concern is growing over the U.S. budget deficit.

We believe that this chapter, which has been updated to include Eximbank's clarifying suggestions, accurately describes the varied aspects of export financing competitiveness in Brazil during the past several years. The chapter notes the United States' continued willingness to lend to Brazil during the height of Brazil's financial crisis and the strong competitiveness of U.S. leasing capabilities. It describes the progress achieved under the OECD Arrangement toward the U.S. goals of eliminating export financing subsidies and the use of mixed credits for commercial advantage. At the same time, OECD statistics show the United States as having lagged behind its major competitors in providing long-term direct credits during 1979-83, and business and government representatives do confirm the competitive difficulties posed by foreign competitors' use of parallel and mixed credits. We note that, as of September 1985, the Administration is now showing greater interest in using mixed credits to counter our foreign competitors' use of these.

## CHAPTER 5

### COMPLIANCE WITH TRADE-RELATED INDUSTRIAL POLICY REQUIREMENTS

Brazil has been a leading country in targeting certain industries for accelerated, government-supported national development. Its goal is to replace imported products and technologies with Brazilian ones and, in the process, to alleviate balance-of-payments deficits through decreased imports and increased exports. In addition to providing tax incentives and government subsidies, Brazil has also used trade-restrictive measures as a means to develop selected industries. These measures include preferential government procurement favoring Brazilian firms, exclusionary market reserve policies favoring the development of "infant" industries and technologies, and investment performance requirements, such as technology transfer, local content and export pressures, and Brazilian majority equity requirements.

The trade effects of such restrictive policies can be significant since whole sectors can be closed off to foreign imports in order to protect the local developing industry. This has been the case, for example, since the 1970s, when Brazil targeted certain segments of its informatics and aircraft sectors for national development, closing out foreign exporters of these products or forcing them to transfer technology and locate in Brazil in order to compete in the Brazilian market.

The trade issues emerging from Brazil's industrial policies in such high-technology areas as informatics and aircraft are relatively new and are not generally governed by international disciplines such as the GATT and its codes. Investment performance requirements are proliferating in the developing world, but U.S. efforts to bring these under the GATT have been resisted both by LDCs and by many industrialized countries. Services issues arising from trade barriers affecting information systems and data flows are also not covered by the GATT. Discriminatory government procurement practices are partially covered under the GATT Government Procurement Code, but Brazil, like most LDCs, is reluctant to sign this code. Infant industry protections are allowed temporarily under the GATT, especially for LDCs, and these may be coupled with national security or balance-of-payments arguments which are difficult to dispute multilaterally.

Without established international discipline, there is wide latitude for foreign countries and firms to respond to Brazil's industrial targeting practices. Competitive factors enabling foreign firms to compete in the Brazilian informatics and light aircraft markets have consequently shifted from traditional

price, quality, and financing considerations to the key Brazilian concern now--the firms' willingness to comply with technology transfer, local content, and Brazilian majority equity and management control.

Few U.S. and foreign firms have acquiesced happily to these kinds of pressures, but when the alternative is exclusion from a potentially major market, some firms have sought to find ways to accommodate Brazilian demands. Overall, foreign firms are viewed by their U.S. competitors and some Brazilians as often more willing and able than U.S. firms to comply with these requirements. But we found only anecdotal information to confirm this and no evidence that competitor governments advise their firms to comply.

The U.S. government has reacted to the imposition of these requirements and restrictions by actively seeking to broaden GATT's coverage to include investment, services, and high technology issues, but has not been successful. As a result the U.S. government has come to address such issues primarily on a bilateral basis. Competitor governments have reacted by lending some support to U.S. multilateral initiatives but also by relying mostly on bilateral approaches.

#### TYPES OF TRADE RESTRICTIONS FACED BY U.S. AND FOREIGN EXPORTERS

Foreign firms interested in exporting to Brazilian markets where Brazil has active industrial policies face protective import restrictions, preferential government procurement practices, exclusionary market reserve policies, and investment performance requirements.

#### Informatics

Brazil's basic strategy for the informatics sector has been to reduce dependence on imported technology by developing its capabilities to manufacture its own technologies. To achieve this objective, Brazil has applied its market reserve policy. Foreign affiliates have been pressed to shift majority equity and management control to Brazilians and to concentrate on producing more sophisticated, state-of-the-art computer goods and services and improving local research and development facilities. Once a product can be manufactured by Brazilian firms, the market segment is closed to imports to give the infant industry a chance to develop. Brazil's industrial policies in the informatics area are the most extensive of any developing country, and LDCs are watching the Brazilian experience closely as a possible model.

For telecommunications equipment, the major barriers to imports are discriminatory government procurement practices,

market reserve policy, restrictive import licensing, and high tariffs. The government's procurement preferences given to Brazilian-majority companies have been a major barrier to imports, since government organizations account for over 90 percent of all telecommunications purchases. With respect to foreign investments, the Brazilian government since 1978 has been encouraging the sale to Brazilian firms of major equity shares in these affiliates and has forced some foreign firms out of the market by dropping them from its list of approved suppliers. As a result of these policies, Brazil, in little over a decade, has freed its telecommunications sector from heavy dependence on foreign goods and technology and has modernized its telephone services to the point where long distance and major city service equals that of most European nations.

The Brazilian computer industry emerged in 1977 and 1978, following a government decision to promote the development of the mini-computer industry by allowing five selected Brazilian controlled firms to license foreign technology. Although Brazil still imports large computers, mainly from the United States, and the value of these is still significant, smaller computers and peripherals are increasingly manufactured domestically.

Foreign software and data flows face (1) registration requirements for all computer programs used in Brazil in order to learn what types of software are needed by what businesses, so that Brazil can direct its software development efforts to serve these needs, (2) technology transfer pressures such as disclosure of source codes,<sup>1</sup> (3) mandatory location of data bases and data processing services in Brazil, (4) exclusion in cases where Brazil has its own capabilities, and (5) monitoring through required passage through a telecommunications gateway or special approval to establish direct data links circumventing the gateway. The Brazilian government views the flow of data across national borders as commercially similar to the flow of goods and therefore subject to control and taxation based on the value of the data rather than the value of the carrier medium.

As of June 1985, it was not clear what the new Brazilian government's policies will be regarding the continuation of these protective policies. In general, the Brazilian government maintains that control over information is crucial to national sovereignty and economic development; and the Brazilian industry and the general public strongly supports a closed market and eventual relinquishment of control and ownership to Brazilians.

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<sup>1</sup>Source code information allows programs to be duplicated, and its disclosure is viewed by the U.S. software industry as a violation of proprietary rights and damaging to U.S. exports.

## Aircraft

In the 1970s Brazil actively began to develop the general aviation and helicopter segments of its aircraft sector. Through a variety of domestic subsidies the government helped found Embraer in 1969 as the country's preeminent aircraft manufacturer in order to increase domestic production of its civil and military aircraft needs, and it founded Helibras in 1977 (with 45 percent French ownership) as Brazil's primary helicopter manufacturer.

Brazil had been a major market for U.S. exporters of light aircraft until 1974, when the Brazilian Air Ministry instructed Embraer to seek a licensing arrangement with a U.S. firm to build a line of light aircraft in Brazil. To protect the fledgling industry after the licensing agreement was concluded, the Brazilian government effectively closed the market to remaining American manufacturers through import restrictions and prohibitively high tariffs. The U.S. licensor won its prime position, according to Embraer, because it offered the Brazilians assembly of aircraft "kits" without any royalty obligations (in essence a partnership arrangement).

The founding of Helibras posed few immediate trade problems for U.S. helicopter exporters, because so far Helibras is assembling only a very lightweight helicopter and Brazil's civilian and military needs are much broader than this. More recently, however, serious questions were raised by Brazil's decision to purchase large helicopters from Helibras' French parent, Aerospatiale, despite adverse competitive factors. In any case, Brazil continues to demand technology transfer and local production from foreign firms seeking access to the Brazilian market.

### TRADE ISSUES POSED BY THESE RESTRICTIONS

Trade restrictions arising out of Brazil's industrial policies in such areas as informatics and aircraft pose a variety of trade issues, most of which are not resolvable under existing internationally-agreed rules.

#### Investment performance requirements

Investment performance requirements distort patterns of trade and investment that otherwise would have been determined by comparative advantage. Local content requirements may increase employment, but the resulting inefficiency may also lead to higher costs for domestic consumers and loss of employment in the exporting country. Technology transfer and majority equity requirements are major export and investment deterrents for companies which have developed advanced technology at great expense. At the same time such firms may depend on exports to achieve economies of scale and reduce innovation costs, and the

loss of export markets may limit their abilities to innovate or produce efficiently. When majority equity requirements are applied to existing investments, foreign investors may feel forced to disinvest altogether if they do not want to transfer technology and management control; and questions of adequate compensation may also rise. Export percentage requirements for investment function like an export subsidy by forcing increased exports and possibly displacing other exports from world markets.

Efforts to bring such practices under international discipline have not been successful. The GATT does not cover such requirements and many countries resisted a U.S. initiative in November 1982 to bring these under GATT discussions. OECD understandings on investment practices do not apply to LDCs, and the United Nations Conference on Trade and Development discussions on investment have focused more on controlling the actions of multinational firms.

#### Discriminatory government procurement

Brazil has openly practiced discriminatory government procurement to favor Brazilian suppliers in the informatics and aircraft sectors as well as in other sectors, in order to develop emerging industries deemed to be of national interest. It has not indicated when or whether it will discontinue such local preferences, even if such industries become fully developed. Like many developing countries, Brazil's government procurement accounts for a large percentage of Brazil's total consumption.

Brazil is not bound by any international disciplines in its procurement practices. It has chosen not to sign the GATT Code on Government Procurement which was agreed to in 1979. Originally, nineteen countries signed this code and, as of July 1985, only Israel had joined the original signatories.<sup>2</sup>

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<sup>2</sup>Even for the code's signatories, however, several important industry areas are excluded from the code's application. It does not cover purchases of military weapons and other goods essential to national security and safety or purchases by state and local government agencies. In addition, each signatory excluded certain central government agencies, particularly those that are large purchasers of telecommunications equipment, heavy electrical machinery, and transportation equipment. Further, a number of signatories excluded certain categories of procurement for domestic socio-economic purposes.

## Market reserve

Brazil's policy of reserving certain markets, particularly high-technology ones, for Brazilian majority and in some cases wholly-owned firms is an extreme form of national preference, having clear trade effects such as (1) pressing foreign investors to divest equity using import privileges as leverage, and (2) totally excluding foreign investment and imports, even technology imports, from some segments.

GATT provisions applying to such practices are covered by Article XVIII which, while calling for notification and consultation procedures, also recognizes that special exceptions from normal GATT principles may be applied to developing countries seeking to develop infant industries.

Brazil's exclusionary practices in the general aviation area cannot be addressed multilaterally because Brazil has not signed the GATT Agreement on Trade in Civil Aircraft.

## Infant industry protection

Brazil could defend its exclusionary import restrictions on informatics products, light aircraft, and other emerging basic industries by arguing that these are permitted by GATT Article XVIII, under which contracting parties recognize that special governmental assistance may be required to promote the establishment, development, or reconstruction of particular industries. Developing countries have made broad use of this infant industry argument in defending trade-restrictive practices, and the concept of "special and differential" treatment for LDCs has been affirmed in several of the codes negotiated as part of the GATT Tokyo Round.

The issue of "graduation" from infant industry protections has been much discussed internationally but not resolved. Until some progress is made in defining infant industry growth criteria and the point at which countries or sectors should be graduated, import restrictions protecting emerging basic industries will continue to be a problem for exporters.

GATT also permits trade restrictions for national security reasons (Article XXI) and for balance-of-payments reasons (Article XII). Both of these articles might be invoked by Brazil if formal complaints were filed against its informatics and aircraft policies.

## Restrictions on free flow of information

The emergence over the last decade of electronic data transfers as a key form of information exchange has raised a number of new trade policy issues and has highlighted the basic

problem that no internationally-agreed rules support the free flow of information. These issues are clearly illustrated in Brazil, the developing country that has implemented or advocated the most extensive regulation for data flows.

Revolutionary developments enabling processed data to be sent from computers and satellites through telephone lines to other computers and terminals have produced vast networks of information lines around the world. Countries such as Brazil have come to view such information links in the light of their national security and sovereignty and have sought to develop their own information resources through the outright restrictions and data flow regulations described earlier. For firms providing data services and equipment as well as for any business relying on worldwide communications for financial, marketing, and management needs, such requirements pose serious barriers to the free flow of information.

A basic trade problem needing resolution is whether information flows and software as "intangibles" are "goods" covered by the GATT or are services. Data processing and data base services in any case are not covered by the GATT or any other international discipline, and Brazil like many other countries has resisted any multilateral regime which might threaten its own plans to develop its information systems.

Brazil's monitoring of information flows through a telecommunications gateway and software registry opens the possibility for exclusion and censure and facilitates political as well as economic control. Whether this should be permissible also needs to be addressed internationally.

Setting tariffs based on the value of the information rather than of the carrier medium (cassette, tape, etc.) similarly permits restrictions on information flows. Brazil has taken the position in the GATT Customs Valuation Committee that all countries be allowed to assess duties on the invoice value of the computer software rather than on the value of the carrier. In September 1984 the Committee resolved this interpretation problem by permitting countries to value software, for purposes of customs duties, using either method. Brazil is one of a few countries which has indicated it will use the invoice value method.

The lack of protection of intellectual property rights for software is another trade issue needing resolution, because copying software has become endemic in Brazil. Neither patent nor copyright protection is effectively available for software in Brazil. Although Brazil is a member of both international organizations on copyrights (the Universal Copyright Convention and the World Intellectual Property Organization) these organizations have no adjudicatory or enforcement roles, and

laws relating to software protecting have not been tested in the Brazilian court system.

Brazil prefers to establish separate rules for software rather than adhere to the generally accepted practice that software is governed by copyright laws. As of June 1985 there were several legislative proposals for a sui generis form of protection. Commerce noted that if such a law were passed, Brazil would become the first country to deviate from the international consensus that copyright is the most adequate and effective form of protection for computer software.

#### U.S. RESPONSE TO TRADE ISSUES

The U.S. government has responded to the trade issues posed by Brazil's industrial policies both multilaterally and bilaterally. U.S. attempts to get discussions of these issues in multilateral forums such as the GATT or OECD, however, have not been successful in achieving international discipline in these areas or in bringing Brazil under existing rules. Bilateral approaches in Brazil's case have proved only slightly more effective so far.

#### Investment performance requirements and market reserve

Over the last several years, the U.S. government has led efforts to get such multilateral forums as the GATT and the OECD to work on investment practices that distort trade and investment flows. Some progress was made in the 1970s within the OECD in achieving agreement that foreign direct investment receive treatment "no less favorable than that accorded domestic enterprises"; but such agreement applies only to developed countries, does not bind signatories to their provisions, and lacks enforcement mechanisms. Dialogues among developed and developing countries on the subject, however, have been much less productive, with North-South discussions in the United Nations focusing on the problems posed by transnational corporations.

Within the GATT, the United States proposed at the November 1982 GATT Ministerial Meeting that GATT establish a work program to examine the use of performance requirements by member countries and their implications for the GATT and world trade. Opposition from many LDCs, including Brazil, however, blocked a GATT consensus on this proposal, and the United States dropped it at the meeting.

Also, the United States used the GATT dispute settlement process in March 1982 to address Canadian performance requirements. The GATT panel found in June 1983 that Canadian government local content regulations requirements were inconsistent

with GATT obligations. But, at the same time, the panel noted that in light of special GATT provisions relating to developing countries, it was not clear whether LDC performance requirements are similarly objectionable under the GATT.

Investment issues are politically sensitive because they involve foreign ownership and control over national economic resources. Although investment performance requirements are proliferating, particularly in the developing world, the strong opposition from LDCs to merely examining the issue indicates the difficulty of dealing with this issue in any multilateral forum.

Bilaterally, the United States has (1) initiated discussions of investment performance requirements in trade talks with the Brazilians and (2) has sought since late 1981 to negotiate bilateral investment treaties with developing countries.

For informatics issues, the United States has achieved virtually no progress through bilateral approaches, although in 1983, for the first time, Brazil's informatics policies and practices were included on the discussion agenda. The U.S. government has tried to persuade the Brazilians of the trade-distorting effects of such investment requirements and the adverse technological effects of its exclusionary trade and investment policies in the informatics area. But U.S. officials have been wary of pressing too hard for changes in Brazil's informatics policies out of concern of generating nationalistic backlash against U.S. firms. Although many U.S. firms in Brazil have been pressed to give up majority equity and some have disinvested altogether, the U.S. government as of the end of 1984 has not had to intervene with the Brazilian government on behalf of individual firms claiming they were not receiving fair value for their equity.

In the general aviation area, also, U.S. bilateral representations since 1976 have had virtually no success in reopening the Brazilian market to U.S. exporters of light aircraft. A key problem for negotiators in this sector is that Brazil is expected to be an important market for U.S. exports of high-value larger aircraft, and too much U.S. pressure in support of light aircraft exports might backfire to the disadvantage of larger U.S. aircraft exporters.

Recognizing that multilateral approaches for investment issues have not been very successful, the United States in 1981 shifted its overall strategy to negotiating bilateral investment treaties (BITs), a practice many European nations and Japan have long engaged in. The U.S. standardized prototype BIT contains such provisions as: national and most favored nation treatment of U.S. investment, avoidance of investment performance requirements, and unconstrained repatriation of profits and other remittances to the U.S. investors. The U.S. government has had

consultations with about 30 developing countries, but advanced LDCs such as Brazil with much U.S. investment have not shown interest in such negotiations. U.S. BITs are quite detailed, compared with those negotiated by Europeans, and the United States as of the end of 1984 has signed only six--with Egypt, Panama, Haiti, Costa Rica, Senegal, and Zaire. The U.S. policy against performance requirements has been one of the major problems in negotiating such treaties.

#### Government procurement and infant industry arguments

The U.S. government seeks to broaden the coverage of the Government Procurement Code and to persuade more countries to sign it. Similarly, the United States seeks some multilaterally accepted definition of infant industry and standard for graduation. No significant progress toward these goals is expected in the near future, however.

#### Restrictions on data flows

The United States has raised the issues posed by Brazil's data policies in bilateral discussions with Brazil and has also raised the general topic of the free flow of information in some multilateral forums. But so far the Brazilian government has proved adamant in its determination to pursue its present policies.

#### U.S. BUSINESS RESPONSE TO BRAZIL'S REQUIREMENTS

We found no definitive pattern of U.S. business responses to Brazil's requirements; some U.S. firms have complied with Brazilian demands, whereas others have basically abandoned interest in the Brazilian market for the near future. U.S. informatics companies have supported the U.S. government's low-key bilateral approach to the Brazilians, but are disappointed in the lack of progress so far, even in deterring further restrictions. U.S. manufacturers of general aviation aircraft worked with U.S. trade officials to protest bilaterally Brazil's restrictive policies but have had no success in reopening the Brazilian market.

#### Questionnaire results

Investment performance requirements were reported by 18 percent of the respondents to be a barrier to entering the Brazilian market to a great or very great extent and by 31 percent as a similar barrier for firms expanding operations. Compliance with Brazil's local content and technology transfer requirements was deemed of great or very great importance by 44 and 41 percent respectively of all respondents, with 31 percent

noting Brazilian majority equity requirements and 22 percent noting export percentage requirements to be of similar importance.

Of the U.S. businesses that had invested in Brazil in the past 10 years, 28 percent had been forced to divest assets in Brazil because of Brazil's investment policy. Of these, only 31 percent requested U.S. government assistance and 75 percent found it supportive of their situations. As U.S. approaches for dealing with Brazilian investment policy, respondents primarily favored negotiating a bilateral investment treaty (32 percent) and using a low-key, persuasive approach (29 percent), with 19 percent recommending pursuing a multilateral approach. This response basically reflects the overall priorities of the Administration, although there has been little interest from Brazil in negotiating a bilateral investment treaty. Despite the respondents' apparent satisfaction with U.S. support for their particular situations, however, more than half of those U.S. firms having basis to compare U.S. and foreign competitors' support for their investors reported that U.S. government support compares either unfavorably or very unfavorably.

#### U.S. business response to Brazil's mini-computer and light aircraft policies

In the mid-1970s the Brazilian government decided to develop a minicomputer capability by establishing several Brazilian firms to be linked with foreign firms willing to transfer technology. Two U.S. firms showed interest in such an arrangement. Negotiations with one broke down because the Brazilian government required that ownership of the firm's technology be transferred to the Brazilian firm at the end of the license period. This firm chose to forego participation in the growing Brazilian market rather than release its technology to the Brazilian firm. The other U.S. firm was willing to assist the Brazilian firm in developing the self-sufficiency necessary to manufacture and market one of its computer products in Brazil. It entered into technology transfer, technical assistance, training, and product purchase agreements with the Brazilian firm and in turn received exemption from import controls and preferred access to the growing Brazilian minicomputer market.

A similar situation arose in the mid-1970s for U.S. light aircraft manufacturers. The Brazilian government decided to make continued participation in its market (at the time the single largest export market for U.S. light aircraft) contingent on a firm's willingness to join with the Brazilian partner Embraer to begin a light aircraft production program in Brazil. The joint enterprise was to receive government support and protection by prohibitive tariffs on import competition.

Three U.S. manufacturers were contenders for the Brazilian firm's foreign partner. According to Embraer, the three firms were fully apprised of Brazil's plans to develop their own technical, managerial, and marketing capabilities in small aircraft production and to reserve the domestic market for Brazilian-produced aircraft in the future. Thus, only the foreign firm willing to enter into agreement with Embraer would be permitted continued participation in the large Brazilian market.

One U.S. firm dropped out as a serious contender quite early, asserting that if Brazil wanted its aircraft, it would have to import them from its U.S. facilities. Another U.S. firm refused to grant Embraer authority to modify its model, apparently out of concern for its quality and performance standards, and would not agree to Embraer's insistence that it not pay royalties for manufacturing know-how acquired from the foreign partner. The third U.S. firm took a more flexible approach and agreed to the above conditions as well as provided technical training and assistance to component supplier industries. Once the agreement was signed, Brazil in 1975 imposed a 50 percent tax (raised from 7 percent) on imported small aircraft, and importers were required to make 1-year, interest-free deposits to the government covering the full price of the aircraft. As a result, imports from the first two U.S. companies, as well as others, were basically closed out.

In the telecommunications area, a major U.S. firm was one of several foreign firms selected by the Brazilian government to help to modernize its telephone system equipment, provided that they sell majority equity to Brazilian partners. The U.S. firm complied with this requirement in 1979, selling 51 percent equity to Brazilian interests. But in 1981 the company, reportedly disenchanted with Brazilian government delays in purchases, sold its 49 percent share to its Brazilian partner and ended its operations in Brazil.

#### FOREIGN RESPONSES TO BRAZIL'S REQUIREMENTS

Little systematic information is available on foreign business responses to investment performance requirements in general, and virtually none is available for Brazil. There is no international reporting system for performance requirements, and countries may not want to formally reveal them where they are applied informally in private negotiations with foreign investors. Both foreign and U.S. businesses may be reluctant to reveal information about their compliance with these if this would provide their competitors with strategic business information or risk negative reaction from host country governments. Indeed, foreign investors may become enthusiastic about these if, as part of their deal, for example, the host government agrees to keep competitors out of the local market.

In addition, countries such as Japan and France have industrial policies of their own and employ some of the same measures as Brazil does to implement them. Thus, they may be unlikely to protest these too publicly or vigorously, either bilaterally or multilaterally. Indeed, both France and Japan have been characterized as only lukewarm in their support of the U.S. initiative at the GATT ministerial meeting in November 1982 to bring investment matters under GATT discussion or study.

Overall, 85 percent of our questionnaire respondents who were able to compare competitors' willingness to accept Brazilian investment performance requirements reported that French, Japanese, and West German firms are more willing or much more willing to accept Brazil's requirements. This perception was reflected also at a National Science Foundation conference in March 1983 on "U.S.-Brazilian Private Sector Cooperation in Science and Technology for the 1980's," where conference participants were both American and Brazilian.

#### French-Brazilian helicopter cooperation

In 1977 Helibras, the only Brazilian helicopter manufacturer, was founded with partial French ownership; 55 percent is now held by the Brazilian State of Minas Gerais and 45 percent by Aerospatiale of France. The French were reportedly eager to gain access to the potentially large Brazilian helicopter market and, to help win the deal, bought 20 planes from Embraer. It does not appear that the French transferred sophisticated technology as part of the deal, but Brazil did expect cooperation to mean an increasing Brazilian role in producing the helicopters.

The Helibras partnership has experienced some major problems, however. Most importantly, the Brazilians have been disappointed because the French did not give the Brazilians as large a role in producing the helicopters as anticipated. Helibras is also reported to have developed a smaller aircraft than the Brazilian Air Force needed, and only a few were purchased. Further, Helibras has had difficulty exporting because the French build the same model and also have it under license to manufacture in the United States.

Our discussions with Brazilian officials and U.S. businessmen revealed that Brazil's key interest in the aviation sector is acquiring technology. Consequently, transfer of technology is a prerequisite for gaining entry to Brazil's helicopter market, and coproduction is a key feature of such technology transfer.

## Japanese response to Brazil's informatics policy

The Japanese have not had the same long-term presence in the Brazilian computer market as U.S. firms have had and consequently have not faced the same disinvestment pressures as have U.S. firms in market segments under market reserve. They have, however, faced the same exclusion from reserved market segments, and neither U.S. firms nor the American embassy could identify ways they may have found to compete more successfully than U.S. firms in these closed markets.

With regard to bilateral representations, the Japanese government and private sector appear to have followed the same course as the United States in seeking to persuade the Brazilians of the disadvantages of its strict market reserve policy through low profile discussions.

In the telecommunications area, however, the Japanese have been more persistent than U.S. firms in tolerating Brazilian policies in order to pursue Brazil's large communications market. As noted earlier, a major U.S. firm sold its remaining 49-percent share in its Brazilian subsidiary in 1981. At the same time, the major Japanese telecommunications firm reportedly paid a Brazilian company \$3.5 million to buy 51 percent of its subsidiary, as well as a \$4.5 million cash bonus in exchange for a guaranteed 45 percent share of Brazil's order for digital switching equipment.

With regard to Japanese investment overall in Brazil, the evidence on recent trends is mixed. On one hand, Japanese Ministry of Finance statistics show Japanese direct investment in Brazil increasing from \$316 million in fiscal year 1981 to \$410 million in 1983. On the other hand, a March 1984 Japanese survey found that, from the end of 1978 through early 1984, 84 Japanese corporations either withdrew from Brazil or became inactive, representing about one in five Japanese corporations in Brazil. Still other reports indicate that some Japanese firms are increasing equity ownership by converting debt into equity in the hope that dividend remittance restrictions would be relaxed.

## AGENCY COMMENTS AND GAO RESPONSE

Both Commerce and State commented that the U.S. government is pursuing multilateral approaches to the trade issues noted in this chapter. State noted that the best way to press for trade liberalization is the multilateral approach and that preparations for new GATT trade negotiations are underway this summer.

With respect specifically to the investment and market access problems posed by the informatics law and proposed software legislation, Commerce noted that in January 1985 the United States requested consultation with Brazil under GATT provisions. It also noted U. S. and foreign government efforts in the World Intellectual Property Organization to counter Brazil's interest in creating a sui generis form of software protection.

We emphasize that multilateral approaches to trade problems are preferable to individual, bilateral agreements. The question is what near-term progress can realistically be expected on many of these politically sensitive trade issues, particularly for a country such as Brazil, which recently has publicly opposed expansion of GATT coverage and the start of new GATT trade talks.

## CHAPTER 6

### CONCLUDING OBSERVATIONS

In our efforts to identify emerging factors in export competitiveness, and the trade policy issues arising from these, we have noted how difficult some of these trade issues are to resolve multilaterally and how bilateral practices can become important competitive factors in such a trade environment.

The bilateral accords dominating the electric energy and certain other sectors in Brazil are clearly the key competitive factor in export sales, and Brazil, like most LDCs, does not appear likely to sign the GATT government procurement code until it has as much to gain as give up by adhering to it. In fact, many of the products covered in our review are explicitly excluded from the code's coverage. The U.S. choice in this sector was basically to imitate our foreign competitors' exclusionary practices or face exclusion from the market ourselves. Whether our competitors use this same technique in other markets needs to be more fully investigated, since we received conflicting evidence on this question. And for the MOUs in Brazil, continued U.S. government efforts to support their successful completion will be important in this initial test case.

Financing techniques such as mixed credits and parallel loans, while not currently as pervasive as we had expected, are likely to be of increased interest to Brazil as its economy and credit standing improve and exporting countries resume their previously aggressive financing tactics. These financing tools, as well as countertrade and leasing arrangements, are reported to be on the rise elsewhere in the world as competitive factors, yet there is no short-term prospect of achieving international agreement governing their use. Certain newer financing tactics such as countertrade and leasing are already being practiced in Brazil, and U.S. and foreign businesses and banks are unquestionably devoting real efforts to mastering them. Even if LDC debt problems are not permanent features of the international economic system, they may persist long enough for these financing techniques to become institutionalized, as firms become adept at using them.

The U.S. government's response to competitor financing tactics has been mixed. On the one hand, Eximbank's \$1.5 billion facility for Brazil represents a special, individualized U.S. government response to the need for continued confidence in the Brazilian economy during a serious financial crisis--a response not matched by our foreign competitors. On the other hand, Eximbank's and AID's mixed credits program suffers from a lack of a clear U.S. government commitment to challenging competitors' financing practices, despite the lack of progress within

the OECD on this subject. Also, the U.S. government's ambivalent attitude to countertrade may need to be clarified--focusing more strongly on pragmatic concerns rather than long-range multilateral goals--in light of the growing use of countertrade around the world and U.S. business interest in handling such demands from financially troubled countries like Brazil, which nevertheless continue to need imports.

Trade-related investment issues arising from Brazil's industrial targeting efforts have also been very difficult to resolve multilaterally, and so there is wide latitude for varying bilateral responses to these. We did not find definitive answers to whether our competitors in Brazil have been more responsive than U.S. firms have been in complying with such investment performance requirements as a means of maintaining market access to sectors Brazil has targeted for national development. The U.S. business community does perceive their foreign competitors to be more compliant with these requirements, but it does not appear this is a result of any competitor government support for such an approach.

Like the bilateral MOUs in the Brazilian energy sector, the recent U.S. interest in signing bilateral investment treaties, while unlikely to help in Brazil, does signal a new U.S. government willingness to concentrate on bilateral solutions to trade problems where recent multilateral efforts have failed to progress. In any case, given the lack of progress in U.S. efforts to moderate Brazil's industrial policies, at least in the informatics and aircraft areas, and the dim prospects for multilateral investment rules, U.S. businesses will individually have to make difficult decisions in responding to these policies and to similar industrial policies elsewhere in the world. And at least in some cases the reality may be that in the short term these industrial policies are non-negotiable.

Because the key competitive factors in the sectors we studied are either not governed by multilateral rules or are inadequately governed, we believe the U.S. government should continue to assess what can be accomplished through multilateral efforts and what issues are likely to remain unresolved. For those areas where no near-term progress in establishing multilateral rules is likely, and thus where competitors' varying bilateral practices can become competitive factors, we believe a U.S. government focus on developing creative, case-by-case responses, is appropriate particularly if these responses encourage other countries to seek multilateral solutions.



**U.S. GENERAL ACCOUNTING OFFICE**  
**SURVEY OF U.S. FIRMS TRADING**  
**IN THE SOUTH AMERICAN MARKET**  
**WITH SPECIAL EMPHASIS ON BRAZIL**

**INSTRUCTIONS:**

Due to congressional interest, the U.S. General Accounting Office, an agency of the Congress, is reviewing the adequacy of existing multilateral trade statutes and agreements which define acceptable forms of international trade behavior.

Using South America, and Brazil in particular, the purpose of this questionnaire is to examine your experience in competing in those markets, specifically with regard to your ability to respond to the various trade tactics employed by your major foreign competitors. It is hoped that by eliciting this information we can identify what U.S. industry believes is the appropriate role of the Federal government in the international marketplace. In this package you will find an enclosure which details an attempt by the Federal government to assist U.S. exporters in the energy area in Brazil. This enclosure will be referred to in Part III.

All information provided will be treated as confidential and will be used only in an aggregated form. Please complete the questionnaire and return it in the pre-addressed envelope within 10 days. Complete your answers by either checking the appropriate box or filling in the indicated blank. If you should have any questions, please call either Robert Tomcho on (202) 634-5316 or Virginia Hughes on (202) 275-5889.

In the event the envelope is misplaced, the return address is:

U.S. General Accounting Office  
 441 G Street N.W. Room 4148,  
 Washington, D.C. 20548

Attn: Robert R. Tomcho

Thank you for your help.

**PART I: YOUR FIRM'S EXPORT INTERESTS IN BRAZIL**

1. Please check the categories listed below in which your firm exports one or more products or services to Brazil. (Include any related components.) *(Check all that apply.)*

- 1.  Energy
- 2.  Telecommunications
- 3.  Data processing/information systems
- 4.  Aircraft/avionics
- 5.  Electronic equipment (not noted above) *(Specify general categories.)* \_\_\_\_\_

If your firm does *not* or has not attempted to export any of the above products to Brazil during the past three years, please check the box below and return the questionnaire in the enclosed envelope. Thank you. ☐

2. How many manufacturing and/or assembly subsidiaries in the above areas do you have in Brazil? *(Check one.)*

- 1.  None *(SKIP TO QUESTION 4.)*
- 2.  One
- 3.  Two
- 4.  Three
- 5.  Four or more

3. Which of the following best describes your Brazilian subsidiaries? *(Check all that apply.)*

- 1.  Minority joint venture
- 2.  50/50 joint venture
- 3.  Majority joint venture
- 4.  Wholly-owned subsidiary
- 5.  Other. *(Please specify.)* \_\_\_\_\_

4. What were your firm's exports, worldwide, from the U.S. in the product areas specified in Question 1) in calendar years 1981, 1982, and 1983? *(Check one box for each row.)*

(in millions)

	\$0-10 (1)	\$11-24 (2)	\$25-100 (3)	\$101-200 (4)	Over \$200 (5)	
1. 1981						(17)
2. 1982						(18)
3. 1983						(19)

5. What were your firm's total exports from the U.S. to Brazil in the product areas specified in Question 1) in calendar years 1981, 1982, and 1983? *(Check one box for each row.)*

(in millions)

	\$0-10 (1)	\$11-24 (2)	\$25-100 (3)	\$101-200 (4)	Over \$200 (5)	
1. 1981						(20)
2. 1982						(21)
3. 1983						(22)

6. Enter below the approximate percentages (by value) of your export sales to Brazil made to each of the following for the calendar years 1981, 1982, and 1983. (Enter percentages. Each year should sum to 100%.)

**BY VALUE**

	1981 (1)	1982 (2)	1983 (3)	
1. Brazilian Government	___%	___%	___%	(23-31)
2. Brazilian Private Sector	___%	___%	___%	(32-40)
3. Your Subsidiary	___%	___%	___%	(41-49)
<b>TOTALS</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	

7. To what extent, if any, do you consider Brazil to be an important export market for your firm in the future (1985-90)? (Check one.)

- 1.  To a very great extent
- 2.  To a great extent
- 3.  To a moderate extent
- 4.  To some extent
- 5.  To little or no extent
- 6.  Don't know

**PART II: COUNTERTRADE IN THE BRAZILIAN MARKET**

NOTE: Unless otherwise noted, all questions in this section refer only to countertrade with Brazil.

**DEFINITIONS**

Any of the following practices are included under the term countertrade.

- 1. **BARTER.** A one-time exchange of goods or services without the introduction of any cash payment. Arranged under one contract.
- 2. **COUNTERPURCHASE.** Seller agrees to buy back something from the original buyer or another entity equalling the full or partial value of the initial sale.
- 3. **BUY-BACK COMPENSATION.** Seller of machinery technology or turnkey project agrees to be compensated with goods produced from the purchased equipment or technology.
- 4. **OFFSET.** Supplier agrees to market products produced in the buyer's country or to allow some portion of the goods sold (often military hardware) to be manufactured in the buying country to "offset" the price of the original goods.
- 5. **SWITCH TRADING.** A triangular arrangement under which a third party is concurrently brought into a countertrade transaction to accept the countertrade obligation of the original seller.

8. Is your company involved in countertrade transactions with Brazil?

- 1.  Yes
- 2.  No (SKIP TO QUESTION 17.)

9. What percentages (by value) of your exports to Brazil have involved some form of countertrade for 1981, 1982, and 1983? (Check one box for each column.)

**BY VALUE**

	1981 (1)	1982 (2)	1983 (3)	
1. 0%				(52-54)
2. 1 to 4.99%				
3. 5 to 9.99%				
4. 10 to 24.99%				
5. 25 to 49.99%				
6. 50% or over				

10. Approximately what percentages (by value) of your countertrade agreements were initiated by (1) the Brazilian government, (2) the Brazilian private sector, or were (3) self-initiated for 1981, 1982, and 1983. (Enter percentages. Each year should sum to 100%.)

**BY VALUE**

Initiated by...	1981 (1)	1982 (2)	1983 (3)	
1. Brazilian Government	___%	___%	___%	(55-63)
2. Brazilian Private Sector	___%	___%	___%	(64-72)
3. Self-initiated	___%	___%	___%	(73-81)
<b>TOTALS</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	

11. Approximately what percentage (by frequency) of your countertrade agreements were initiated by (1) the Brazilian government; (2) the Brazilian private sector; or (3) were self initiated for 1981, 1982, and 1983? (Enter percentages. Each year should sum to 100%.)

**BY FREQUENCY**

Initiated by...	1981 (1)	1982 (2)	1983 (3)	
1. Brazilian Government	___%	___%	___%	(82-90)
2. Brazilian Private Sector	___%	___%	___%	(91-99)
3. Self-initiated	___%	___%	___%	(100-108)
<b>TOTALS</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	

12. How many times, if at all, has your firm been involved in the following transactions in Brazil for 1981, 1982, and 1983? (Enter numbers for each year. If none, enter "0".)

	Barter	Counterpurchase	Buy-Back Compensation	Offset	Switch Trading	
	(1)	(2)	(3)	(4)	(5)	
1. 1981	(109-110)	(111-112)	(113-114)	(115-116)	(117-118)	
2. 1982	(119-120)	(121-122)	(123-124)	(125-126)	(127-128)	
3. 1983	(129-130)	(131-132)	(133-134)	(135-136)	(137-138)	

13. In your firm's counterpurchase agreements with Brazil, what has been the average value of the contract counterpurchase commitment? (Check one.) (If no counterpurchases, skip to Question 16.)

- 1.  Less than 25% of the value of the sales contract (15)
- 2.  25% of 50% of the value of the sales contract (16)
- 3.  Over 50% of the value of the sales contract (17)

14. Are the goods counterpurchased in Brazil by your firm generally marketed in (1) Brazil; (2) the U.S.; (3) other countries; (4) sold to middleman or ETCs; or (5) used by your company internally? (Check all that apply.)

- 1.  Marketed in Brazil (18)
- 2.  Marketed in the United States (19)
- 3.  Marketed in other countries (20)
- 4.  Sold to middlemen or export trading companies (ETCs) (21)
- 5.  Used by your company internally (22)

15. Which of the following goods, if any, are usually counter-purchased by your firm in Brazil? (Check all that apply.)

- 1.  Consumer goods (23)
- 2.  Food or other agricultural products (24)
- 3.  Raw materials (25)
- 4.  Machinery and equipment (26)
- 5.  Components and spare parts (27)
- 6.  Other (Please specify.) \_\_\_\_\_ (28)

16. To what extent, if any, has the U.S. government assisted you in your countertrade agreements with Brazil? (Check one.)

- 1.  To a very great extent
- 2.  To a great extent
- 3.  To a moderate extent
- 4.  To some extent
- 5.  To little or no extent

17. How many sales to Brazil, if any, have you lost to your foreign competitors primarily because of your unwillingness to arrange a satisfactory countertrade agreement during 1981, 1982, and 1983? (If none, enter "0".)

Number of sales lost

1. 1981	(29-30)
2. 1982	(31-32)
3. 1983	(33-34)

(If you entered "0" for all years, skip to Question 19.)

18. Please check below the value of these contracts that were lost to foreign competitors in Brazil during 1981, 1982, and 1983. (Check one box for each year.)

(in millions)

	Not Applicable	\$0-10	\$11-25	\$26-100	\$101-200	Over \$200	
	(1)	(2)	(3)	(4)	(5)	(6)	
1. 1981							(35)
2. 1982							(36)
3. 1983							(37)

19. If you believe you have lost bids in the Brazilian market because of countertrade inducements provided by foreign competitors, or may lose bids in the future, which of the following best describes your attitude toward countertrade in the future? (Check one.)

- 1.  Would consider meeting or exceeding countertrade provisions by competitors on a case-by-case basis (38)
- 2.  Would not consider countertrade under any circumstances (39)
- 3.  Not applicable (40)
- 4.  Other (Please explain.) \_\_\_\_\_ (41)

20. In your view, which of the following approaches, if any, should the U.S. government use in the countertrade area? (Check one.) (38)
1.  Work to eliminate U.S. countertrade with Brazil and other countries.
  2.  Recognize the practice as necessary in today's world and work with U.S. business to use it effectively.
  3.  Do not actively encourage it or discourage it.
  4.  Other *Please explain.* \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

22. In your opinion, which of the following best describes the Federal government's attitude toward U.S. commercial countertrade transactions, worldwide? (Check one.) (40)
1.  Very encouraging
  2.  Encouraging
  3.  Neither encouraging nor discouraging
  4.  Discouraging
  5.  Very discouraging
  6.  Don't know

21. In your opinion, will the need to countertrade worldwide increase, decrease, or remain about the same in importance for your firm in the future (1985-90)? (Check one.) (39)
1.  Greatly increase
  2.  Somewhat increase
  3.  Remain about the same
  4.  Somewhat decrease
  5.  Greatly decrease
  6.  Don't know

23. How does the U.S. government's attitude toward countertrade worldwide compare with that of foreign governments? (Check one.) (41)  
 Foreign governments generally are...
1.  much more receptive
  2.  more receptive
  3.  same attitude
  4.  less receptive
  5.  much less receptive
  6.  no basis to judge

24. To what extent, if any, do firms in each of the following countries use countertrade as an inducement in contract negotiations worldwide? (Check one box in each row.)

	To a Very Great Extent (1)	To a Great Extent (2)	To a Moderate Extent (3)	To Some Extent (4)	To Little or No Extent (5)	Don't Know (6)
1. France						
2. Japan						
3. W. Germany						
4. Other (Specify):						

**PART III: GOVERNMENT/INDUSTRY RELATIONS AND THEIR EFFECT UPON EXPORTS TO BRAZIL**

25. To what extent, if any, do the differing economic systems of France, Japan, W. Germany, (e.g., more government involvement at the industry level than in the U.S.), put you at a disadvantage in bidding against them in Brazil on large capital intensive or turnkey projects? (Check one box in each row.) (If your product is not affected by foreign competition, please check "Not applicable.")

	To Little or No Extent (1)	To Some Extent (2)	To a Moderate Extent (3)	To a Great Extent (4)	To a Very Great Extent (5)	Not Applicable (6)
1. France						
2. Japan						
3. W. Germany						
4. Other (Specify):						

26. In your competition in Brazil with foreign suppliers from France, Japan, and W. Germany, to what extent, if any, do the governments of those countries use political and/or economic pressure to get export contracts? (Check one box in each row.) If your product is not affected by foreign competition, please check "Not applicable."

	To Little or No Extent (1)	To Some Extent (2)	To a Moderate Extent (3)	To a Great Extent (4)	To a Very Great Extent (5)	Not Applicable (6)	
1. France							(54)
2. Japan							(55)
3. W. Germany							(56)
4. Other (Specify:)							(57)

(If you checked "To little or no extent" or "Not applicable" for all countries, Skip to Question 28.)

27. If the foreign governments listed below have used political and economic pressure in Brazil, to what extent, if any, has this been a major factor in losing awards to your competitors? (Check one box in each row.) If pressure has not been used, or if your product is not affected by foreign competition, please check "Not applicable."

	To Little or No Extent (1)	To Some Extent (2)	To a Moderate Extent (3)	To a Great Extent (4)	To a Very Great Extent (5)	Not Applicable (6)	
1. France							(54)
2. Japan							(55)
3. W. Germany							(56)
4. Other (Specify:)							(57)

28. The U.S. and Brazil have recently signed several bi-lateral trade accords in the energy area (see enclosed), in response to similar European and Japanese practices. To what extent, if any, have similar bilateral trade agreements in energy or other sectors between Brazil and France, West Germany, or Japan reduced your ability to compete in the Brazilian market? (Check one box in each row.)

	To Little or No Extent (1)	To Some Extent (2)	To a Moderate Extent (3)	To a Great Extent (4)	To a Very Great Extent (5)	No Basis to Judge (6)	
1. France							(54)
2. Japan							(55)
3. W. Germany							(56)

29. France, Japan, West Germany, or other countries' bilateral agreements may or may not cause trade access problems for your firm in countries *other than* Brazil. Please indicate below: whether or not your firm has access problems with countries *other than* Brazil, and, if yes, specify the country market, product/service, and the nature of the problem. (Check one box under Access Problems? and enter comments where appropriate.)

Exporting Country	Access Problems?			If yes.		
	No (1)	Yes (2)	Don't Know (3)	Country Market (4)	Product/Service (5)	Nature of Problem (6)
1. France						
2. Japan						
3. W. Germany						
4. Other Countries (Specify:)						

(If you answered "No" or "Don't Know" for all countries, skip to Question 31; otherwise, continue.)

30. If these trade agreements have restricted your ability to compete, which of the following best describes your firm's reaction? (Check all that apply.)

- 1.  Withdrew from those markets (7)
- 2.  Sought U.S. government assistance (3)
- 3.  Sought association with foreign firms benefiting from agreement (7)
- 4.  Other (Please specify: \_\_\_\_\_) (3)
- 5.  Not applicable (trade agreements have not restricted your ability to compete.) (1)

31. To what extent, if any, do you believe U.S. government-to-government accords (1) can be, and (2) should be used in other sectors in Brazil and other markets? (Check one box in each row.)

	Very Great Extent	Great Extent	Moderate Extent	Some Extent	Little or No Extent	No Opinion
	1	2	3	4	5	6
1. Can be used						
2. Should be used						

**PART IV. INVESTMENT IN BRAZIL**

32. To what extent, if any, have Brazil's investment performance requirements been a barrier to you either (1) entering, or (2) expanding your operations in Brazil? (Check one box in each row.)

	Very Great Extent	Great Extent	Moderate Extent	Some Extent	Little or No Extent	Not Applicable
	1	2	3	4	5	6
1. Entering Brazil						
2. Expanding Operations						

33. Has your firm made any direct investments in Brazil in the past 10 years? (86)

- 1.  Yes
- 2.  No (SKIP TO QUESTION 37.)

34. Have you been forced to disinvest any of your assets in Brazil because of Brazilian investment policy? (87)

- 1.  Yes
- 2.  No (SKIP TO QUESTION 37.)

35. As a result of your disinvestment in Brazil, did you request U.S. government assistance? (88)

- 1.  Yes
- 2.  No (SKIP TO QUESTION 37.)

36. If yes, how would you characterize U.S. government support for your situation? (Check one.) (89)

- 1.  Very supportive
- 2.  Supportive
- 3.  Neutral
- 4.  Nonsupportive
- 5.  Very nonsupportive

37. Which of the following approaches, if any, do you believe the U.S. government should use in dealing with Brazilian investment policy? (Check one.) (90)

- 1.  Pursue multilateral effort to get Brazil to change policies which restrict foreign investment
- 2.  Use a low-key approach to try to persuade the Brazilians that an unrestricted investment policy would be more beneficial to their development strategy
- 3.  Do nothing and respond only to individual investment problems and requests for assistance on an ad-hoc basis
- 4.  Attempt to negotiate a bi-lateral investment treaty which would guarantee certain rights to investors such as guaranteed access to off-shore sources of components and parts, repatriation rights for profits and capital, etc.
- 5.  Other (Please explain.) \_\_\_\_\_

38. Overall, how favorably or unfavorably does the U.S. government compare to the governments of France, Japan, and W. Germany in responding to the concerns of their investors in Brazil? (Check one box in each row.)

The U.S. government compares...

	Very Favorably	Favorably	Neither Favorably nor Unfavorably	Unfavorably	Very Unfavorably	No Basis to Judge
	(1)	(2)	(3)	(4)	(5)	(6)
with						
1. France						
2. Japan						
3. W. Germany						

39. To what extent, if at all, is compliance with the following investment performance requirements essential for your firm in order to invest in Brazil? (Check one box in each row.)

	To Little or No Extent (1)	Some Extent (2)	Moderate Extent (3)	Great Extent (4)	Very Great Extent (5)	No Basis to Judge (6)
1. Local content						
2. Technology transfer						
3. Brazilian majority equity						
4. Export percentage requirements						
5. Other (please specify.) _____						
_____						
_____						

40. Are French, Japanese, and W. German firms more or less willing than your firm to accept Brazil's investment performance requirements? (Check one box in each row.)

	much less willing (1)	less willing (2)	about same (3)	more willing (4)	much more willing (5)	Don't know (6)
1. French firms are ...						
2. Japanese firms are ...						
3. W. Germany firms are ...						

42. During the past 3 years in the South American Market, to what extent, if at all, have France, Japan, and W. Germany lived up to their obligations under the OECD agreements? (Check one box in each row.)

	To Little or No Extent (1)	To Some Extent (2)	To a Moderate Extent (3)	To a Great Extent (4)	To a Very Great Extent (5)	No Basis to Judge (6)
1. France						
2. Japan						
3. W. Germany						

**PART V: QUESTIONS RELATED TO FINANCING AND INSURANCE FOR EXPORTS TO SOUTH AMERICA**

41. To what extent, if at all, are you familiar with the Organization for Economic Cooperation and Development's (OECD) agreement on official export financing, governing allowable interest rates and terms? (Check one.)

- 1.  To a very great extent
- 2.  To a great extent
- 3.  To a moderate extent
- 4.  To some extent
- 5.  To little or no extent. (SKIP TO QUESTION 49.)

(If you answered "To a Very Great Extent" or "No Basis to Judge" for all countries, skip to Question 47; otherwise, continue.)

43. If France, Japan, and W. Germany are not abiding by the agreement, which of the following forms of circumvention are being used? (Check all that apply for each column.)

	France (1)	Japan (2)	W. Germany (3)
1. Lower than allowable interest rates			
2. Longer than allowable repayment periods			
3. Other forms which, while not technically prohibited, are not in the spirit of the OECD Agreement and are a form of predatory financing. Please specify.			

44. If circumvention is taking place in South America, have you ever complained formally to the U.S. government about it? (109)  
*(Check one.)*

- 1.  Yes. *(SKIP TO QUESTION 46.)*
- 2.  No

45. If not, which of the following reasons, if any, is primarily responsible for your not complaining? *(Check one and then skip to Question 47.)* (110)

- 1.  Lack of concrete information
- 2.  Information became known too late
- 3.  Didn't expect U.S. government to act on our behalf.
- 4.  Other *(Please specify:)* \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

*(Skip to Question 47.)*

46. Which of the following was the U.S. government's response to your complaint of circumvention in South America? *(Check one.)* (111)

- 1.  The Export/Import Bank came through with financing terms enabling you to compete successfully
- 2.  The U.S. government complained to competitor government and its financing terms were amended to abide by the Agreement's parameters
- 3.  U.S. government's response came too late to enable you to compete
- 4.  U.S. government did not respond because it said your information was incomplete
- 5.  Other *(Please specify:)* \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

47. How successful or unsuccessful would you rate the Agreement in preventing predatory financing in the South American Market? *(Check one.)* (112)

- 1.  Very successful
- 2.  Successful
- 3.  Neither successful nor unsuccessful
- 4.  Unsuccessful
- 5.  Very unsuccessful
- 6.  No basis to judge

48. How effective or ineffective would you rate the performance of the U.S. government in taking steps to guarantee that our foreign competitors are living up to their OECD obligations in South America? *(Check one.)* (113)

- 1.  Very effective
- 2.  Effective
- 3.  Neither effective nor ineffective
- 4.  Ineffective
- 5.  Very ineffective
- 6.  Don't know

49. During 1981-83, do you believe you lost contracts in South America largely due to the Export/Import Bank's inability to match the rates and terms offered by competitor country institutions? (114)

- 1.  Yes
- 2.  No. *(SKIP TO QUESTION 51.)*

50. Which of the following factors, if any, made the Export/Import Bank's offer uncompetitive? *(Check all that apply?)*

- 1.  Uncompetitive interest rates (115)
- 2.  Uncompetitive repayment period (116)
- 3.  Lack of local cost financing (117)
- 4.  Foreign exchange rate insurance coverage (118)
- 5.  Mixed credits (119)
- 6.  Parallel credits, i.e., credits provided for unrelated transactions (120)
- 7.  Other *(Please specify:)* \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

(121)

51. During 1982 and 1983, what was the dollar value of your sales to the South American market, if any, which were sourced from your subsidiaries in countries other than the U.S. primarily because more competitive financing was provided by those countries? (Check one box in each column.)

	1982 (1)	1983 (2)
1. \$0		
2. \$1 to 4.9 million		
3. \$5 to 9.9 million		
4. \$10 to 19.9 million		
5. \$20 to 49.9 million		
6. \$50 to 99.9 million		
7. \$100 million and over (Please specify:)		

**PART VI: GENERAL**

52. Has Brazil's market reserve policy i.e., reserving domestic markets for Brazilian suppliers, increased, decreased or not changed your exports to that market? (Check one.)

- 1.  Greatly increased
- 2.  Somewhat increased
- 3.  Remained about the same
- 4.  Somewhat decreased
- 5.  Greatly decreased

53. To what extent, if at all, have current export controls or the threat of future controls affected your image as a reliable supplier vis-a-vis your competitors in the South American market? (Check one box in each row.)

	To Little or No Extent (1)	To Some Extent (2)	To a Moderate Extent (3)	To a Great Extent (4)	To a Very Great Extent (5)	No Basis to Judge (6)
1. Current export controls						
2. Threat of future controls						

54. To what extent, if any, has the strength of the U.S. dollar during the past 3 years been a factor in reducing your competitiveness in the South American market. (Check one.)

- 1.  To a very great extent
- 2.  To a great extent
- 3.  To a moderate extent
- 4.  To some extent
- 5.  To little or no extent
- 6.  Don't know

55. To what extent, if any, do U.S. government-financed feasibility studies performed by independent U.S. engineering consulting firms, increase your chances of winning export contracts in Brazil and other South American countries. (Check one box in each row.)

	To Little or No Extent (1)	To Some Extent (2)	To a Moderate Extent (3)	To a Great Extent (4)	To a Very Great Extent (5)	Don't Know (6)	Not Applicable (feasibility studies not needed for our industry) (7)
1. Brazil							
2. Other S. American countries							

56. Overall, how frequently or infrequently does the U.S. government finance feasibility studies in *Brazil* compared to the governments of France, Japan, and West Germany? (Check one box in each row.)

The U.S. government finances feasibility studies in *Brazil*:

	Much More Frequently	More Frequently	About as Often	Less Frequently	Much Less Frequently	Don't Know
than	(1)	(2)	(3)	(4)	(5)	(6)
1. France						
2. Japan						
3. W. Germany						

57. Overall, how frequently or infrequently, does the U.S. government finance feasibility studies in other *South American* countries compared to the governments of France, Japan, and West Germany? (Check one box in each row.)

The U.S. government finances feasibility studies in other *South American* countries:

	Much More Frequently	More Frequently	About as Often	Less Frequently	Much Less Frequently	Don't Know
than	(1)	(2)	(3)	(4)	(5)	(6)
1. France						
2. Japan						
3. W. Germany						

58. If you have any comments on the previous questions or on trade tactics of your major competitors in *South America*, or *Brazil* in particular, please use the space provided below or attach another sheet.

Please provide below the name, title, and telephone number of the person responding to this questionnaire in case we need to clarify any responses.

NAME: \_\_\_\_\_

TITLE: \_\_\_\_\_

TELEPHONE: (\_\_\_\_) \_\_\_\_\_

THANK YOU FOR YOUR HELP.

EXAMPLEMEMORANDUM OF UNDERSTANDING

For the development of coal gasification and related coal projects in Brazil.

Between: Ministry of Mines and Energy,  
Government of the Federative Republic of Brazil  
and The Department of Commerce of the United States of America

Signed and agreed by:

The Honorable Cesar Cals de Oliveira Filho  
Minister of Mines and Energy  
Government of the Federative Republic of Brazil  
and Guy Fiske  
Deputy Secretary  
Department of Commerce of the United States of America

Whereas

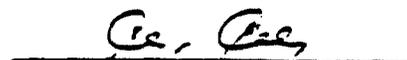
The Government of Brazil intends to develop its coal resources to produce synthetic natural gas and other fuels to assist in achieving the goal of oil import substitution.

It is agreed that

1. Brazilian Ministry of Mines and Energy and the U.S. Department of Commerce will work together to assist their respective private sectors in joint collaboration to apply the latest state of the art technology and equipment to the development of Brazil's coal resources and to produce synthetic natural gas and other hydrocarbons.
2. Discussions should take place as soon as possible between officials of the Ministry and the Department to provide a favorable environment for the participation of their private sectors, and then between private sector parties on both sides with the objective of concluding commercial contracts. It is contemplated that these contracts will be concluded before the end of 1984 and that additional contracts may follow in 1985 and 1986.
3. This memorandum is an expression of the official interest of the Ministry and the Department and of their intent to use their good offices to facilitate the timely conclusion of the commercial contracts.



Guy Fiske  
Deputy Secretary  
U.S. Department  
of Commerce



Honorable Cesar Cals de  
Oliveira Filho  
Minister of Mines and Energy  
Government of the Federative  
Republic of Brazil

Brasilia, April 12, 1983



EXPORT-IMPORT BANK OF THE UNITED STATES  
511 VERMONT AVENUE, NW  
WASHINGTON, DC 20571

TELEPHONE 202-566-2117

June 12, 1985

Mr. Frank C. Conahan  
Director  
National Security and International  
Affairs Division  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Conahan:

This is in response to your request for comments on the draft of a proposed GAO report entitled "Emerging Issues in Export Competition: A Case Study of the Brazilian Market". Our comments may be grouped into three categories. First, we believe more analysis could be made of the actual trade figures with Brazil during the period under review - particularly the continuing high U.S. sales to Brazil compared with the shares of other countries. Second, we find a number of inaccurate criticisms of Eximbank, evidently made by firms with little knowledge of our programs or those of our counterparts in other countries and we believe these comments should be eliminated in some cases and corrected or brought up-to-date in other cases. We have described these inaccuracies in Attachment I. Finally, there have been some recent developments, including decisions taken at the OECD Ministerials this past April, which you may wish to include in your report.

In selecting Brazil, you have chosen a country whose situation has changed dramatically in recent years. Following years of rapid growth led by investment intended to make the country more self-sufficient, Brazil had to limit severely imports of all kinds - even capital goods which would have contributed to self-sufficiency, because of the debt service problems which began in late 1982. Against this background of changing circumstance it seems noteworthy that the United States' share of Brazilian capital goods imports (excluding aircraft) remained in the range of 28 to 31 percent in the years 1979-83 with an exceptional jump to 37 percent in 1982. In other words, the U.S. as a whole maintained its share of capital goods sales to Brazil even though the absolute amount dropped sharply as Brazil cut back its imports in 1983. Surely this performance says something about the resiliency of U.S. exporters and the support programs of their government.

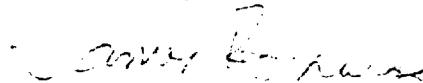
- 2 -

We would mention, in regard to the negotiations among OECD countries to reduce or eliminate those mixed credits which are trade distorting, that we have succeeded best in past negotiations when we used an array of tactics both diverse and unpredictable, which did not include adopting the system we wanted our competitors to discontinue. Other countries have established programs in the past three years to counter the mixed credits of countries which have been active longer - France, Canada, and Austria. No country is satisfied with the present system, and all want to restrict in one way or another, the practices of their competitors. We believe that tighter restrictions can be negotiated in coming months which will reduce the number of trade-distorting mixed credits.

Some progress has been made already. No doubt you will want to include in your paper a reference to the OECD Ministerial Meeting of April 11 and 12, 1985, at which time the minimum grant element for tied aid credits was increased from 20% to 25% and a study was ordered to be prepared during the summer, addressing other ways to restrict trade-distorting tied aid credits. We enclose a copy of the relevant portion of the OECD Ministerial Communique and OECD implementing message (Attachment II).

We thank you for this opportunity to review your report.

Sincerely,



James R. Sharpe  
Senior Vice President  
Direct Credits and Financial Guarantees

Attachments (2)

## Attachment I

## EXIMBANK COMMENTS ON:

GAO REPORT ON EMERGING ISSUES IN EXPORT COMPETITION: A  
CASE STUDY OF THE BRAZILIAN MARKETCover Policy toward Brazil - Eximbank and Competitors

As your study properly states (in the Digest on page vi and in the body on page 60) many other OECD countries' export credit agencies stopped or greatly reduced their export credits for Brazil in 1982, while Eximbank alone remained active in the country. Your comment on page 68 that Eximbank "implemented its facility (for Brazil) based on minimal documentation (of similar action by other competitors)" seems to imply that the Bank moved forward without satisfactory assurance that this condition had been met. In fact, the Bank had received notice from the U.S. Treasury Department that the IMF had been assured that the necessary contributions for trade insurance and guarantees would be forthcoming from other official creditors. As a result, the Bank was satisfied that this condition precedent had been met.

(now pp. iv and 45-7)

(now p. 46)

You may want to bring your report up-to-date by reporting that in 1984 the other countries relaxed some or all of their restrictions, so that at present France is prepared to provide short, medium, and long term financing in substantial amounts while other countries are prepared to provide short term (up to 180 days) cover and many are also willing to consider terms of 5 years and longer on a case-by-case basis.

Extraordinary Support

We are surprised that you include "inflation risk insurance" in your list (on page 63) of extraordinary support which other countries provide while Eximbank does not. Several of the countries which formerly provided this support, notably the United Kingdom, have now phased out their programs. In any case, the best way to help exporters who are concerned about inflation is to control inflation, as this Administration has done, so that an insurance policy becomes unnecessary.

(now p. 41)

In that same page you cite "local cost guarantees", and "lines of credit for countries or projects" as assistance which Eximbank does not provide. In fact, Eximbank will provide local cost guarantees when convinced that the competitive situation and the nature of the project makes such support appropriate. We are extremely reluctant, but not absolutely opposed, to lines of credit for countries because we want to be as sure as possible that each loan is facilitating a U.S. export which would not otherwise take place. Section 2(b)i(B) of the Export Import Bank Act of 1945 as amended states that "so far as possible . . . (Eximbank) loans shall generally be for specific purposes." As to lines of credit for specific projects, such financing has been a major part of our business for many years and it is an area where some of our European competitors are still trying to catch up with us.

Eximbank Support of Leasing Industry

More attention might be given to your comment on page 71 that the U.S. equipment leasing industry holds a 75% share of the world cross-border leasing market. It is this very fact, the relative strength of our private industry, (and not a lack of knowledge about trade implications), which has led our leasing committee to proceed carefully in recommending steps to broaden our own program. If we go beyond our present efforts to provide a necessary supplement to our own strong industry in the form of lease guarantees, we should do so in the knowledge that our counterparts in foreign countries will surely copy us and our exporters will lose part of the advantage they now enjoy from our strong private leasing industry.

(now  
p.48)Mixed Credits

We note that your section on mixed credits (following page 64) uses tables prepared within Eximbank to estimate the magnitude and distribution of mixed credit offers. In many cases two or more countries have offered funds for the same project, so an addition of all offers greatly overstates the magnitude of trade distortion which mixed credit offers might cause. In any case, such distortion is a small portion of world trade, or even Brazilian imports, in the period you are studying.

(now  
p.41)

You refer, on page 75, to short-lived and unsuccessful U.S. government efforts to discourage mixed credits in 1979 - 1980. At that time and continuing until 1983, the mixed credit issue was not ignored, but primary attention in OECD negotiations on export credits was given to a much broader problem: minimum rates of interest for all official export credits and how they could be adjusted regularly and automatically to stay in close relation with market rates of interest. Our efforts in that direction, which we began in 1979 and intensified in 1981, had a successful conclusion when the formula for automatic adjustments of the matrix took effect in the fall of 1983. Thus, it was with a record of success in reducing subsidies that we turned our primary attention to mixed credits at December meetings of the OECD. As we mention in the cover letter and shown in Attachment II, the minimum grant element of mixed credits has been increased this year from the 20% level set in 1982 to 25%. By increasing in this way the minimum degree of concessionality we increased the cost to donor governments which should reduce the frequency of trade-distorting mixed credits.

(now  
pp.  
50-1)Business Perceptions of U.S. Export Financing

This section could be improved by shifting the emphasis away from general comments about Eximbank's lack of competitiveness and by placing more emphasis on ways that the Bank has become more competitive in recent years. Many respondents to your questionnaire admit to a lack of knowledge of the OECD Arrangement which sets standards for official export credits - such as minimum cash payment, minimum interest rate, maximum repayment terms. Unfortunately, too many of the companies you questioned also seem not to know that Eximbank does provide competitive financing directly or through commercial banks when we have reason to believe that comparable financing is available from our competitors, at interest rates and on repayment terms as favorable as permitted under the Arrangement.

Attachment I

Page 3

Your report could remind exporters of the improvements in our competitive position during the past two years, as a result of such new programs as the Medium Term Credit Program which enables U.S. commercial banks to offer financing for our exporters at the minimum rates of the OECD Arrangement when there is subsidized competition, and the Engineering Multiplier Program to offer attractive financing for feasibility and design services in advance of the competition, when the services are likely to lead to future larger contracts to implement the project.

## OECD MINISTERIAL MEETING

April 11-12, 1985

Action Taken Regarding Tied Aid and  
Implementing Directive of OECD Secretariat

The communique adopted at the end of that meeting contained the following clause:

"Measures aiming at strengthened transparency and discipline in the field of tied aid credits and associated financing of exports will continue to be pursued expeditiously. A study is to be completed by 30 September 1985 so that new measures aiming at a further increase in discipline and transparency could be taken promptly. As a first step, there was agreement on reinforced notification and consultation procedures as well as an increase to 25 percent of the minimum permissible grant element for those transactions."

The Implementing Telex from the OECD Secretariat contained the following interpretation:

"Action under the ministerial decision includes as a first step:

A) the increase of the minimum permissible grant element for tied aid credits and associated financing of exports from 20 to 25 percent.

B) the prior notification of tied aid credits and associated financing of exports with a grant element of less than 50 percent, together with the lengthening from ten calendar to twenty working days of the waiting periods prescribed for matching purposes in the procedures.

C) the institution of a process of face-to-face consultations."



JUN 19 1985

Mr. J. Dexter Peach  
Director, Resources, Community, and  
Economic Development Division  
United States General  
Accounting Office  
Washington, D.C. 20548

Dear Mr. Peach:

This is in reply to GAO's letter of April 19, 1985, requesting comments on the draft report entitled "Emerging Issues in Export Competition: The Case of the Brazilian Market."

We have reviewed the enclosed comments of the Under Secretary for International Trade and believe they are responsive to the matters discussed in the report.

Sincerely,

A handwritten signature in cursive script that reads "Kay Bulow".

Kay Bulow  
Assistant Secretary  
for Administration

Enclosure



6 JUN 1985

Mr. J. Dexter Peach  
Director  
United States General Accounting Office  
Washington, DC 20548

Dear Mr. Peach:

Thank you for the opportunity to comment on your draft report, "Emerging Issues in Export Competition: A Case Study of the Brazilian Market". Specific points are addressed in the enclosure.

We question the report's premise that Brazil's unorthodox trade practices are illustrative of the kind of trade environment we increasingly face abroad. Although Brazil shares debt and liquidity problems with other LDCs, the trade practices explored in the report may be unique not only to Brazil but to a particular Brazilian administration as well. Also, we disagree with the report's assumption that there has been something fundamentally wrong with our ability to compete in Brazil. Indeed, U.S. exports have maintained their overall share of total Brazilian imports despite the strong dollar.

I would like to note that our commercial Memoranda of Understanding (MOUs) with Brazil are not bilateral trade accords in the traditional sense, but limited agreements that grant U.S. firms first right of refusal on specific projects. While MOUs have been used effectively in Brazil, and could have application in other countries, we think their significance as a trade policy tool is overstated in the report. I believe the U.S. Government should focus more attention on addressing directly Brazilian restrictions than on adapting ourselves to those restrictions. Likewise, we do not believe countertrade is likely to have a significant effect on U.S. exports to Brazil. Finally, we disagree with the report's characterization of Eximbank programs for Brazil as uncompetitive, especially in view of recent examples where the Bank has offered aggressive financing.



In view of our serious reservations about basic aspects of the report, we believe it requires significant revisions before publication.

Sincerely,



Lionel H. Olmer

Enclosure

### General

While we agree that Brazil's debt crisis has posed serious challenges to U.S. exporters, we believe that the GAO report greatly overstates the threat to U.S. export competitiveness posed by the bilateral trade practices employed by the Brazilian government. In our view, the evidence and arguments presented by GAO fail to support their contention that U.S. firms have lost competitiveness in Brazil due to the greater willingness of competitor governments to employ "innovative" trade practices in support of exports.

The GAO findings are sometimes inherently contradictory. Evidence presented in some sections of the report conflicts with data presented in other sections. Also, on a number of critical issues, statistics cited by the GAO in support of its arguments are outdated or otherwise insufficient.

In our view, the ability of U.S. firms to increase market share despite sharp cutbacks in Brazilian imports at the height of the debt crisis indicates that U. S. competitiveness in Brazil has, if anything, been significantly stronger than that of our competitors. This interpretation of the data, however, is not given due consideration in the GAO report. Likewise, we believe that the GAO's statement that "overall U.S. business perceptions regarding Eximbank competitiveness ... were negative," is unwarranted, given the narrow sample of U.S. firms included in the GAO's poll.

### MOU Strategy

It may be useful to point out what our commercial MOUs with Brazil are not. They are not broad bilateral accords designed to sustain the overall competitiveness of U.S. exports to Brazil in the face of the debt crisis. Rather, they are focused narrowly on keeping U.S. firms from being locked out of certain major projects in Brazil. The trade effects of our MOUs are not short-term; U.S. exports would follow years later.

The Figueiredo administration used access to these projects as leverage to obtain parallel balance-of-payments financing. In doing so, the Brazilian Government deliberately bypassed standard open bidding procedures. Until we countered with our own MOUs, our European competitors were --by default-- the principal beneficiaries of Brazil's policy. We do not yet know whether the Sarney administration will follow the MOU approach to major projects.

### Aircraft Policies

- It should be emphasized that the United States has a strong balance of trade surplus with Brazil in the aerospace sector. The report contains no exact figures on U.S.-Brazil aerospace trade, but it is now running about 6 to 1 in favor of the United States.

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- References are made to kits of "light" aircraft being imported to be assembled in Brazil, while the domestic market is closed to like aircraft. However, no mention is made of the Bandeirante and Brasilia, two domestically designed and produced aircraft which are also receiving protection from the Brazilian Government. The protection includes exclusion of aircraft not produced in Brazil from the domestic market under the "Law of Similar", difficulty in obtaining import licenses, and high tariffs (70 percent). In the export marketing of Brazilian aircraft, subsidized interest rate financing is also available.
- Only indirect mention is made of sales in Brazil of large transport aircraft, and of attempted parallel financing by the French on behalf of Airbus Industrie. U.S. manufacturers of large transport aircraft --which are not produced at all in Brazil-- have been quite successful selling to the Brazilians.
- Reference is made to the problem presented by the differing interests of manufacturers of large transport aircraft and manufacturers of general aviation aircraft, i.e., those aircraft competitive with the "light" aircraft (also with the 19- and 35-passenger aircraft). Mention ought to be made of the fact that domestically produced (not just assembled) aircraft contain a significant proportion (20-40 percent) of U.S.-produced components, and that the manufacturers of these components side with the manufacturers of large transport aircraft with regard to U.S. Government aerospace trade policy.
- The first sentence of para. 3, p. 83 might better read: "The founding of Helibras posed few immediate trade problems for U.S. helicopter exporters, because Helibras at first assembled only a very lightweight helicopter and Brazil's civilian and military needs were much broader than this." Then might follow: "More recently serious questions have been raised by a decision to purchase large helicopters from Helibras' French parent, Aerospatiale, despite adverse competitive factors." (now p.57)

### Informatics

With regard to informatics and software issues, the draft needs to be updated to reflect the U.S. Government's actions and a few Brazilian Government developments over the last few months. Such an update would acknowledge our multilateral approach to these problems and thereby convey the sense that the U.S. Government is undertaking efforts to address both these highly visible and controversial issues. The study tends to dwell on the bilateral nature of our

-3-

economic relations with Brazil in this area which is not entirely the case. It also leaves the general impression that there is little we can do multilaterally to address the investment and market access problems posed by the informatics law and proposed software legislation. We would suggest mentioning the following specific U.S. Government actions:

- U.S. Government request in January 1985 to the Brazilian Government for consultations under Article XXII of the GATT to discuss Brazil's informatics policies. These consultations took place in Geneva on June 13-14, 1985.
- U.S. and foreign government efforts in the World Intellectual Property Organization (WIPO)/UNESCO to counter Brazil's interest in creating a sui generis form of software protection. An important joint WIPO/UNESCO meeting was held in February 1985 to discuss the adequacy of current copyright protection for computer software. The meeting's report states quite objectively that Brazil was alone in its position that copyright did not provide adequate protection.

Specific comments include:

- P. 87, Infant Industry Protection: In the opening sentence, "can" should be changed to "could."
- P. 90, Software Protection: The third sentence reads: "Neither patent nor copyright protection is effectively available for software in Brazil, because Brazil prefers to establish separate rules for software rather than generally accepted practice that software is governed by copyright laws." This is not exactly correct. Copyright protection is available inasmuch as Brazil is a signatory to both the international conventions, as is noted later in that paragraph. The problem is more a question of whether or not that protection for software has been tested in the Brazilian court system. Further, one might clarify the Brazilian "preference" for a sui generis form of software protection. To date there reportedly are several legislative proposals for a sui generis form of protection but none have been introduced in the current Congress. It would be worthwhile to note that if such a law were passed, Brazil would become the first country to deviate from the international consensus that copyright is the most adequate and effective form of protection for computer software.

(now  
pp.  
60-1)

Methodology

- o The GAO questionnaire is plagued by biased and/or imprecise wording of questions. Serious problems of one kind or another are evident on questions 2, 6, 7, 8, 9, 12, 16, 21, 25, 27, 28, and 47 --comprising fully one-fifth of all survey questions. Responses to many of these questions are key to the GAO's overall findings and recommendations.
- o Further methodological problems exist in the phrasing, formatting, and scaling of the multiple choice answers to the questions posed. Deficiencies exist on at least one quarter of the survey items: e.g., questions 6, 7, 10, 11, 14, 16, 20, 26, 31, 32, 37, 53, and 54.
  - Those answer choices that support the GAO case tend to be couched in rhetorical language that contrast sharply with blandly-phrased alternative answers (e.g., on questions 20 and 37, which are key to the GAO argument). Accepted survey technique mandates that all multiple choice answers be value-neutral and give respondents no hint of what the surveyor is looking for.
- o As a result of the above, the survey data collected by GAO may not provide a true picture of the respondents' views.
- o The report also contains numerous flaws in the interpretation of questionnaire results. One of the most common errors is the tendency to utilize partial or inconclusive survey responses as the basis for broad generalizations about Brazilian trade patterns.
  - The GAO's finding that U.S. exporters are being hurt by a lack of USG assistance in meeting Brazilian countertrade demands reflects the views of only a very small portion of questionnaire respondents (7 percent) who reported having direct experience with countertrade in Brazil.
  - Similarly, the proposition that "U.S. exporters are at a disadvantage in overseas markets due to foreign government intervention," was supported by only 17 percent of the survey respondents.
- o Elsewhere, the percentage of respondents answering a given question is not specified, making it impossible to determine whether the GAO's conclusions are warranted or not. (See findings on U.S. and competitor requirements, pp. 96 and 100).
- o Another consistent problem is the tendency to lump response categories together, implying stronger agreement with the GAO's findings than is warranted by actual survey results.

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- For example, 77 percent of the survey respondents were reported to have believed that countertrade "would either somewhat or greatly increase" in the future. From this presentation it is impossible to tell whether the majority felt it would "greatly" increase or increase only "somewhat."
- Without providing the actual breakdown of responses, the GAO can only say that countertrade is expected to increase--a significantly weaker conclusion than implied in the draft report.
- o A further fundamental weakness is the lack of any statistical evidence in support of the GAO's contention that U.S. competitiveness in Brazil has eroded since the debt crisis began in 1982. Indeed, the draft report presents data which undercuts this key argument.
  - Brazilian import statistics cited by the GAO actually show that there were significant increases--not decreases--in the U.S. market share in each of the four market sectors studied.
  - For example, the GAO's own figures show that the U.S. share of Brazil's telecommunications equipment imports rose markedly from 26 percent in 1979 to 44 percent in 1983; in the informatics sector, the U.S. share increased from 51 percent to 56 percent; in energy equipment, from 26 percent to 31 percent; while in avionics equipment, the U.S. share jumped from 58 percent to a striking 72 percent (see pages 9-10).
- o The report also fails to include even partial trade figures for 1984, which may shed additional light on recent U.S. export performance in Brazil as well as the effect of the ongoing recovery in world trade and the global economy on Brazilian countertrade demands and other bilateral trade practices.

### Miscellaneous

p. iii, para. 1:  
Canada is a major competitor, too.

p. vi, para. 2:  
Parallel balance-of-payments financing was a component of these financial packages and also the principal motivation for then Planning Minister Delfim Netto to negotiate them.

-6-

p. vi, para. 3:

The tariff surcharges of 30 to 100 percent were removed in late 1984 and replaced in some cases by a higher basic duty. It should be noted that import duty exemptions or reductions are commonly granted; in fact, we understand that only about 10 percent of Brazil's imports pay full duty. Also, the IOF tax has been reduced on many products, from 25% to 15%.

p. vii, para.2:

Brazil is seeking to extend market reserve to new areas.

p. 14, para.4: (now p. 11)

Europeans, especially the French, have had more success than we in using bilateral approaches to capture business in Brazil's electrical energy sector. But as the table on page 10 shows, European suppliers have not really "dominated" the market.

p. 44, para. 2: (now p. 29)

It should be noted that the bilateral trade agreements discussed in this section are not clearing arrangements.

p. 65, para. 2: (now p. 45)

Eximbank met a French mixed credit challenge in Brazil in March 1985.

p. 81, para. 1: (now p. 56)

The third sentence should read "With respect to foreign investments, the Brazilian government since 1978 has been encouraging the sale of major equity shares in these affiliates to Brazilian firms and has forced some foreign firms out of the market by dropping these firms from the GOB list of approved suppliers."

p. 90, para. 2: (now p. 61)

The second sentence should be eliminated and replaced by: "A draft law that has been submitted to the Brazilian Congress would deny copyright protection for computer software and establish instead stringent registration requirements and only short-term protection."

p. 97, para. 2: (now P. 64)

It would be useful to know how successful commercially this U.S. firm has been in Brazil.

p. 101, para. 2: (now p. 66)

This section seems out of sequence in the report.



United States Department of State

Comptroller

Washington, D.C. 20520

May 22, 1985

Dear Frank:

I am replying to your letter of April 19, 1985 to the Secretary which forwarded copies of the draft report: "Emerging Issues in Export Competition: A Case Study of the Brazilian Market".

The enclosed comments on this report were prepared in the Bureau of Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

A handwritten signature in cursive script that reads "Roger".

Roger B. Feldman

Enclosure:

As stated.

Mr. Frank C. Conahan,  
Director,  
National Security and  
International Affairs Division,  
U.S. General Accounting Office,  
Washington, D.C. 20548

GAO DRAFT REPORT: Emerging Issues in Export Competition:  
A Case Study of the Brazilian Market

In this study, the GAO has identified various export techniques that have come into vogue in recent years as a means to overcome the trend toward import restrictions and foreign exchange conservation which now typically restrain trade with developing countries and studied their effect on U.S. export competitiveness. The exercise focuses on bilateral trade accords, countertrade, new methods of export financing such as mixed credits, and trade-related national industrial policies which favor protective import restrictions, exclusionary market reserve arrangements designed to reduce dependence on imported technology, and investment performance requirements. Brazil was chosen as the case study.

The drafters of the study found that the Government of Brazil's economic and trade policy is firmly founded on (a) import substitution of both products and technology, (b) preservation of foreign exchange, (c) fulfillment of the country's external debt obligations, and (d) defense of domestic industrial growth and development.

The study was based on the premise that, as a result of the trade effects of the restrictive policies Brazil has adopted since the 1970's, U.S. competitiveness in trade and investment in Brazil has declined. However, although Brazilian imports from all sources clearly declined in volume and value since 1978, the study does not seem to have taken sufficient note that, despite the strong position of the dollar, the U.S. market share of Brazil's imports has remained stable at roughly thirty percent since 1978, well ahead of the combined market shares of Japan, France and West Germany (see Table 1-2 on page 8 of the study), the principal U.S. competitors whose policies were used as comparisons in this study.

The instrument for the study was a questionnaire sent to 274 "high technology firms believed to have recently been active in the Brazilian market." It appears to us that the responses came largely from the relatively unaffected parties rather than the significantly affected ones; i.e., those companies who have been successful in trading or investing in Brazil, despite the GOB's policies, rather than those companies who have not been able, or have not been willing, to do so because of those policies. Also, it is possible that, in view of the addressees, the findings may inadvertently be too narrowly identified with a sector about which the Brazilians have been particularly import-sensitive and the U.S. export-oriented. Regardless of the possible weaknesses of the

-2-

questionnaire approach, we find it significant that the drafters could not prove that any of the exporting firms, or the four exporting countries, involved in the study had expanded their high technology exports to Brazil totally, largely, or substantially because of a willingness to use any or all of the export techniques under discussion. In short, export expansion was only marginally affected, at best.

The study concludes that:

(A) Countertrade, as substantiated by empirical evidence, is an economically unsound, inefficient and expensive way of doing business. We agree. Although we are still gathering information on the actual use, and prevalence, of Countertrade, we believe the drafter's unqualified statement on page 54 that "U.S. firms seem to be gearing up to compete" by the use of such methods as countertrade is too sweeping to be correct. (nqw p.35)

(B) Cross-border leasing was found to be too new to warrant firm conclusions. We agree, but believe this may become a growing phenomenon.

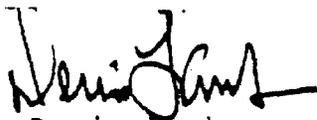
(C) The study devoted considerable space to a review of Brazil's protective import restrictions, preferential government procurement practices, exclusionary market reserve policies (particularly in aircraft and "informatics"--computer hardware and software), and such investment performance demands as technology transfer, local content, and export performance requirements, and Brazilian majority equity obligations. The drafters correctly noted that such trade practices are not adequately governed by existing multilateral trading rules and "the U.S. Government has come to address such issues primarily on a bilateral basis." It is true that we have pursued, and will continue to pursue, our objectives on these issues via bilateral discussions and meetings such as the U.S.-Brazil Trade Sub-group. But this draft does not take into account that preparations for new multilateral trade negotiations are underway and that a meeting of senior officials should be held in the GATT before the end of this summer to discuss the subject matter and modalities of the negotiations. We continue to believe that the best way to press for trade liberalization is the multilateral approach, and we intend to press vigorously in the negotiations for reforms in precisely the restrictive trade and investment practices discussed in this study..

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(D) Based on a review of several Memoranda of Understanding which the U.S. signed with the Government of Brazil, the drafters concluded that such bilateral accords "represent a potentially significant new approach in U.S. trade policy." We believe the drafters were overly optimistic, since the MOUs signed by the U.S. Department of Commerce and the Brazilian Ministry of Mines and Energy have been confined to the development of Brazil's hydroelectric and thermoelectric resources. The Ministry of Mines and Energy's interest in concluding MOUs is colored by the fact that Brazil is energy import-dependent. It is too early to know whether the Government of Brazil will be launching any more major projects in the next decade, and it is unclear whether other ministries would be interested in signing similar MOUs with the U.S. We do not, however, oppose the possibility of concluding bilateral accords with Brazil, and continue to keep this approach in mind, but your study should mention that Memoranda of Understanding, unlike bilateral or multilateral agreements, are not legally binding instruments.

The study is unfortunately already somewhat dated since a) it does not analyze 1984 trade statistics, b) it overlooks the effects on U.S. export competitiveness caused by the strong position of the dollar and the Brazilian policy of periodic devaluation of the cruzeiro, c) it advocates softer mixed credit financing at a time when the role of the EXIMBANK is in flux and there is growing concern over the U.S. budget deficit, and d) it fails to take into the account the possible policy shifts which may result from the change of administration in Brazil.

Some language changes which we recommend in the draft are enclosed separately.



Denis Lamb

Deputy Assistant Secretary  
for Trade and Commercial Affairs

OFFICE OF THE UNITED STATES  
TRADE REPRESENTATIVE  
EXECUTIVE OFFICE OF THE PRESIDENT  
WASHINGTON  
20506

June 6, 1985

Mr. Frank Conahan  
Director  
Division of National Security and  
International Affairs  
General Accounting Office  
441 G Street, N.W.  
Room 4804  
Washington, D.C. 20548

Dear Mr. Conahan:

This is in response to your request for this office's views on the draft report, "Emerging Issues in Export Competition: A Case Study of the Brazilian Market." In general, the report is an accurate, well-rounded review of competitive issues affecting Brazil and the United States. However, there are two difficulties with the draft I wish to raise, i.e., the description of the U.S. Government's policy toward countertrade and the report's emphasis on commercial Memoranda of Understanding (bilateral trade accords) as important U.S. vehicles for Brazilian market penetration.

With respect to countertrade, the draft asserts that the U.S. Government has no agreed position on countertrade. In fact, the Trade Policy Review Group (TPRG) met in July 1983 at the sub-Cabinet level to decide on a policy on countertrade. A summary of the findings and participants in this meeting is enclosed.

Regarding Memoranda of Understanding (MOUs), the report correctly identifies them as one means of securing a niche in the Brazilian market. In addition, the report appears to describe accurately the state of U.S.-Brazil work on MOUs. However, in the view of this office, the text overemphasizes the role that MOUs play in our bilateral trade relations. To date, the MOUs that have been negotiated cover a narrow range of products and projects. Moreover, little work is being done now to develop new agreements.

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In the future, we may be in a better position to assess the impact of these accords. In the short term, however, it appears doubtful that these commercial agreements will figure as prominently in our trade affairs as the report implies.

I appreciate your taking the views of this office into account.

Sincerely,



Marian Barell  
Director for Latin America

Enclosure

U.S. Government Views on Countertrade

Carmen Suro-Bredie  
Director, North-South Affairs  
Office of the U.S. Trade Representative

I. Defining the Countertrade Problem

- A. Estimates of countertrade vary widely. According to the "Economist", countertrade represents about one quarter of the world's international commerce. <sup>1</sup> A GATT economist arrives at a maximum of five percent of international trade. <sup>2</sup> The IMF puts the figure at one percent of world trade. <sup>3</sup>
- B. The exact dollar value of U.S. trade affected by countertrade cannot be determined because U.S. firms are not required to report this information. Also, many goods covered by countertrade agreements are shipped directly to third country markets.
- C. A section 332 study completed by the International Trade Commission estimates that U.S. imports resulting from countertrade totalled \$279 million in 1980, a threefold increase over 1974 figures. <sup>4</sup> The Commission cautions that its data understates the full dollar importance of U.S. countertrade.
- D. The proliferation of countertrade transactions is of concern to the U.S. Government since these practices introduce a degree of distortion into the multilateral trade and payments system.

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<sup>1</sup>"Quid Pro Quo" The Economist, February 20, 1982, P. 76.

<sup>2</sup>Gary Banks, "The Economics and Politics of Countertrade" , The World Economy, Volume 6 No. 2, June 1983, P. 163.

<sup>3</sup>Kyung Mo Huk, "Countertrade: trade without cash?" Finance and Development, December 1983, P. 15.

<sup>4</sup>U.S. International Trade Commission, Analysis of Recent Trends in U.S. Countertrade USITC Publication 1237, Washington, D.C. P. 5.

## II. The Spread of Countertrade and Barter Practices to Developing Countries

- A. A major factor contributing to the establishment of countertrade practices in the East-West context was the compatibility with intra-Eastern European trading practices, especially annual trade plans denominated in quantities or in non-convertible currencies traded through clearing accounts.
- B. Countertrade has spread to LDCs because of increasing difficulties with trade balances. Many LDCs believe that these practices are less costly in political and economic terms than changing the market imperfections that affect their exports and imports. Countertrade is used by LDCs to restrict imports or to obtain imports during periods of foreign exchange scarcity. Other LDCs follow the Eastern European example of using countertrade as a means to force Western companies to market their goods.
- C. The recent, increased use of countertrade and barter in market economies raises the following problems:
  1. These practices return the trading system to bilateralism at a time when the international community is seeking to safeguard and widen a multilateral trading system.
  2. International trade rules have not been applied to barter and countertrade transactions even though these transactions may have the same effect as a new import duty or an export subsidy. GATT rules affecting tariff bindings, consultation and/or retaliation simply do not apply. Carried to the extreme, countertrade could render trade agreements unenforceable.<sup>5</sup>
  3. These practices also affect the international payments system. If developing countries barter their exports instead of sell them, they reduce the foreign exchange available to repay foreign debt. The IMF generally has not looked favorably on countertrade and barter. Its loans and rescheduling of private bank loans are conditional on specific programs for increasing export earnings. These requirements generally are inconsistent with

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<sup>5</sup>Norman S. Fieleke, "Barter in the Space Age." New England Economic Review. November/December 1983, P. 40.

bilateral approaches to trade of the kind typified by barter and countertrade.

4. Countertrade may conceal the real prices and costs of transactions making it possible for a government to subsidize or dump exports when such actions would not be possible through normal channels.
5. Increased use of barter and countertrade may result in the establishment of state trading organizations in both developed and developing countries. Government intervention in the trading system raises the possibility of discrimination and distortion. This intervention is heightened if countertrade or barter arrangements are formalized by long term agreements or monitored by clearing accounts.

### III. The U.S. Government Position on Barter and Countertrade

- A. The Office of the U.S. Trade Representative (USTR) is responsible for coordinating trade policy within the U.S. Government. USTR chaired an interagency committee composed of representatives of the Departments of Commerce, Agriculture, State, Treasury, Labor, Justice, Defense, Interior, Transportation and Energy, the Office of Management and Budget, the Council of Economic Advisors, the National Security Council and the International Development Cooperation Agency, the Export-Import Bank, the Overseas Private Investment Corporation and the United States International Trade Commission to develop a policy on barter and countertrade. The findings of this group are outlined in this section.
- B. In developing a policy on countertrade and barter, the interagency group reviewed the use of these practices in market and non-market economies, the costs and benefits to the countries involved, the implications of countertrade and barter on the articles of the General Agreement on Tariffs and Trade (GATT), and past policy statements by other developed countries in the context of the Organization of Economic Cooperation and Development (OECD). Government officials reviewed the history of U.S. Government involvement in barter transactions and the applicability of U.S. trade laws. Countertrade practitioners and companies opposed to the practice were interviewed. The policy was designed to deal with the conflict between U.S. objectives of multilateralism and the practical necessities of aiding U.S. business interests faced with countertrade requirements.

C. The recommendations of the interagency group include:

1. The U.S. Government generally views countertrade as contrary to an open, free trading system. However, as a matter of policy, the U.S. Government will not oppose U.S. companies' participation in countertrade arrangements unless such action could have a negative impact on national security.
2. The U.S. Government will provide advisory and market intelligence services to U.S. businesses including information on the application of U.S. trade laws to countertrade goods.
3. The U.S. Government will continue to review financing for projects containing countertrade/barter on a case by case basis, taking account of the distortions caused by these practices.
4. The U.S. Government will continue to oppose government mandated countertrade and will raise these concerns with the relevant governments.
5. The U.S. Government will participate in reviews of countertrade in the IMF, OECD and GATT.
6. The U.S. Government will exercise caution in the use of its barter authority reserving it for those situations which offer advantages not offered by conventional market operations.

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