House of Commons
Trade and Industry Committee

Trade with Brazil and Mercosur

Seventh Report of Session 2006–07
Volume I
Report, together with formal minutes

Ordered by The House of Commons
to be printed 22 May 2007
The Trade and Industry Committee

The Trade and Industry Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department of Trade and Industry.

Current membership

Peter Luff MP (Conservative, Mid Worcestershire) (Chairman)
Roger Berry MP (Labour, Kingswood)
Mr Brian Binley MP (Conservative, Northampton South)
Mr Peter Bone MP (Conservative, Wellingborough)
Mr Michael Clapham MP (Labour, Barnsley West and Penistone)
Mrs Claire Curtis-Thomas MP (Labour, Crosby)
Mr Lindsay Hoyle MP (Labour, Chorley)
Mr Mark Hunter MP (Liberal Democrat, Cheadle)
Miss Julie Kirkbride MP (Conservative, Bromsgrove)
Judy Mallaber MP (Labour, Amber Valley)
Rob Marris MP (Labour, Wolverhampton South West)
Anne Moffat MP (Labour, East Lothian)
Mr Mike Weir MP (Scottish National Party, Angus)
Mr Anthony Wright MP (Labour, Great Yarmouth)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at http://www.parliament.uk/parliamentary_committees/trade_and_industry.cfm.

Committee staff

The current staff of the Committee are Elizabeth Flood (Clerk), David Slater (Second Clerk), Robert Cope (Committee Specialist), Ian Townsend (Inquiry Manager), Anita Fuki (Committee Assistant), Jim Hudson (Senior Office Clerk) and John Staples (Secretary).

Contacts

All correspondence should be addressed to the Clerk of the Trade and Industry Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5777; the Committee’s email address is tradeindcom@parliament.uk.
Contents

Report

Summary 3

1 Introduction 5
  This inquiry 5
  Mercosur/Mercosul 5
    Membership 6
  Institutions 9
  Brazil’s economy 9
    The five year growth plan 12
  Brazil: A BRIC in the wall? 13

2 Brazil & the UK 17
  UK-Brazil trade & investment relations 17
  Brazil: The challenge for UK companies 19
  UK Trade & Investment (UKTI) in Brazil 21
    Resources 21
    Priority sectors 23
    Inward investment from Brazil 24
    Activity of UK countries/regions in Brazil 25

3 Barriers & Opportunities 26
  Barriers 26
    Awareness & local knowledge 26
    Language 27
    Import tariffs & customs procedures 27
    Services 30
    Regulation, licensing & bureaucracy 31
    Labour market 32
    Taxation system 32
    Intellectual Property Rights 34
    Other issues 35
  The Joint Economic and Trade Committee (JETCO): Tackling barriers bilaterally 36
    IPR & the JETCO 38
    An Investment Protection & Promotion Agreement (IPPA) 39
    A double taxation agreement 40
  Opportunities by sector 41
    Aerospace 42
    Financial services 43
    Healthcare 45
    Environmental technology 45
    ICT 46
    Oil and gas 46
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>Science co-operation</td>
<td>47</td>
</tr>
<tr>
<td></td>
<td>Government science strategy &amp; Brazil</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>The Global Science &amp; Innovation Forum (GSIF)</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>Joint Commissions</td>
<td>49</td>
</tr>
<tr>
<td></td>
<td>Life sciences &amp; UKTI sector strategy</td>
<td>49</td>
</tr>
<tr>
<td></td>
<td>Science &amp; Innovation Network</td>
<td>49</td>
</tr>
<tr>
<td></td>
<td>The UK-Brazil ‘Year of Science’</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>Biofuels &amp; Ethanol</td>
<td>51</td>
</tr>
<tr>
<td></td>
<td>The UK-Brazil-Southern Africa ethanol partnership</td>
<td>53</td>
</tr>
<tr>
<td></td>
<td>Exploiting bio-diversity</td>
<td>53</td>
</tr>
<tr>
<td>5</td>
<td>Argentina, Paraguay, Uruguay &amp; Venezuela</td>
<td>55</td>
</tr>
<tr>
<td></td>
<td>Argentina</td>
<td>55</td>
</tr>
<tr>
<td></td>
<td>Trade relations with the UK</td>
<td>55</td>
</tr>
<tr>
<td></td>
<td>Opportunity sectors</td>
<td>56</td>
</tr>
<tr>
<td></td>
<td>Barriers &amp; issues</td>
<td>57</td>
</tr>
<tr>
<td></td>
<td>Uruguay</td>
<td>61</td>
</tr>
<tr>
<td></td>
<td>Paraguay</td>
<td>63</td>
</tr>
<tr>
<td></td>
<td>Venezuela</td>
<td>65</td>
</tr>
<tr>
<td></td>
<td>Bolivia</td>
<td>66</td>
</tr>
<tr>
<td></td>
<td>UKTI resources across the Mercosur countries</td>
<td>66</td>
</tr>
<tr>
<td>6</td>
<td>Mercosur’s future, trade relations with the EU, &amp; the Doha Round</td>
<td>69</td>
</tr>
<tr>
<td></td>
<td>Challenges ahead for Mercosur</td>
<td>69</td>
</tr>
<tr>
<td></td>
<td>Imperfect customs union &amp; external tariffs</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>Internal asymmetries</td>
<td>71</td>
</tr>
<tr>
<td></td>
<td>A ‘South American Community of Nations’?</td>
<td>72</td>
</tr>
<tr>
<td></td>
<td>EU-Mercosur relations</td>
<td>72</td>
</tr>
<tr>
<td></td>
<td>The importance of the Doha Round</td>
<td>75</td>
</tr>
</tbody>
</table>

Conclusions and recommendations 78

Formal minutes 84
List of witnesses 85
List of written evidence 86
List of unprinted written evidence 87
Brazil is a key emerging economy, and is an increasingly important global player both in itself and though coalitions with other developing countries. Brazil also dominates Mercosur—the Common Market of the South made up of Argentina, Paraguay, Uruguay and more recently joined by Venezuela—in area, population and economic terms.

However, when considering where to trade and which countries to invest in, UK businesses often overlook Brazil in favour of faster-growing China and India, such that the UK fares poorly in trade and investment relationships with Brazil when compared with its competitors.

The key reasons behind this appear to be a lack of knowledge among UK businesses of the opportunities available in Brazil—in aerospace, financial services, healthcare, environmental technology, Information and Communications Technology, and oil and gas, for example—and insufficient understanding of the barriers—such as bureaucracy, tariffs and taxes—which, while significant, are not insurmountable. The UK and Brazilian governments have set up a Joint Economic and Trade Committee (JETCO) which is looking to tackle these barriers bilaterally. This initiative is welcome, but after around six months of the JETCO process progress appears slow in certain key areas.

The new strategy of UK Trade and Investment (which provides advice and support to exporters), the subject of a concurrent inquiry by the Committee, trains the organisation’s focus on emerging markets away from mature markets in the EU and the US. This has benefited Brazil, where new posts are being established; this is welcome although resources still remain below levels seen in the recent past, with no clear intention to reverse this situation.

This is also the UK-Brazil Year of Science. Brazil has much to offer in this area, through its biodiversity and its expertise in the field of bio-ethanol and areas such as the development of vaccines. The UK Government has previously identified Brazil as a key strategic partner in science, and the various events taking place will result in useful linkages and raise understanding of Brazil’s potential in related sectors.

Among the other Mercosur members, Argentina similarly offers opportunities while also presenting barriers to trade and investment, and Uruguay has also attracted investors, in part due to its stability and proximity to Argentina and Brazil. The UKTI strategy has not had the positive effects seen in Brazil in these other countries: UKTI presence in Uruguay is to be removed, while UKTI has already closed its offices in Paraguay.

Although modelled on the European Union, Mercosur’s economic and political development has been slow, with difficulties arising from Brazil’s dominance, internal disputes and tariff issues within what is intended to be a customs union. Despite this, the EU and Mercosur are currently negotiating a bilateral free trade agreement which would help open the Brazilian and Argentine markets to UK industrial products imports, while reducing the UK prices of agricultural exports from those countries. However, the multilateral Doha Round negotiations at the World Trade Organisation must remain the highest priority for the UK and EU negotiators, as regional agreements are a second-best
route to trade liberalisation, and multilateral fora present the best means to address broader concerns that are unlikely to be resolved on a bilateral basis.
1 Introduction

This inquiry

1. We decided to examine the opportunities for trade and investment between the UK and Brazil as part of a wider programme of inquiries into trade with what have been termed the ‘BRICs’—Brazil, Russia, India and China. As our inquiry progressed we realised that trade relations with Brazil ought to be viewed in a wider context, and we expanded our terms of reference to consider trade and investment opportunities with Mercosur, the South American trade bloc. We retained a special emphasis on Brazil, as that bloc’s economically and politically dominant member.

2. Our inquiry focused on two broad areas:

— the difficulties faced by and opportunities available to UK businesses wishing to trade, or forge investment links, with Brazil and the other Mercosur countries, with particular reference to opportunities in the information technology, life-sciences, oil and gas, aerospace and financial services sectors; and

— the UK Government’s role in assisting businesses, including the relative responsibilities of UK Trade and Investment (UKTI) and the English Regional Development Agencies (RDAs); although broader issues of trade and investment promotion are considered in our parallel inquiry into the new UKTI strategy, which focused on support for manufacturing exports.

3. We initially took written evidence on Brazil and as the inquiry was broadened took further evidence on Mercosur as a whole. We also visited São Paulo in Brazil and Buenos Aires in Argentina as part of the inquiry, and took oral evidence from UKTI, the Confederation of British Industry (CBI), the Minister for Trade and Investment, and the Government’s Chief Scientific Adviser. As a case study, our visit and evidence sessions also helped inform our inquiry into UKTI’s strategy, and vice versa.

Mercosur/Mercosul

4. Mercosur is the Southern Common Market, occasionally referred to as the Common Market of the Southern Cone, and is a contraction of the Spanish Mercado Común del Sur. In Portuguese the bloc is known as ‘Mercosul’, a contraction of Mercado Comum do Sul. Although this report focuses on Portuguese-speaking Brazil, the bloc is referred to as Mercosur throughout as that name is more widely used.

---


5. Following bilateral Brazil-Argentina co-operation in the mid-1980s, neighbouring Paraguay and Uruguay joined them in signing the Treaty of Asunción in March 1991. The ultimate goal was an EU-style common market and customs union between them\(^3\) and a common tariff on goods imports from outside the bloc. In 1994 the Treaty of Ouro Preto gave shape to the bloc’s institutions, made Mercosur a legal entity under international law, and formalised the customs union which came into effect on 1 January 1995. However, the development of Mercosur has been slow and uncertain. It is often referred to as being an imperfect customs union because the common tariff has many national exceptions, its customs territories remain separate, and goods are not free to circulate as they are within the EU.

6. The Trade Minister told us that the Government welcomed the developing relationship between the Mercosur countries, while noting that “each of these countries is entirely different.”\(^4\)

**Membership**

7. Venezuela became Mercosur’s fifth member on 4 July 2006. This saw Mercosur expand from around 235 million people with a total GDP of just over $1 trillion to 261 million people and GDP of $1.14 trillion.\(^5\) It accounts for 75% of South America’s total GDP.\(^6\) Venezuela was previously a member of the Andean Community of Nations (CAN),\(^7\) the other major trade bloc in South America now made up of Bolivia, Colombia, Ecuador and Peru (see Fig. 1). Bolivia recently applied for Mercosur membership, a request currently being considered by a working party,\(^8\) and if it succeeds Bolivia would probably have to leave the Andean Community, as Venezuela has (the future of Mercosur is looked at in Chapter 6 below). Chile is a member neither of Mercosur nor the Andean Community, but is an associate member of both.

8. The CAN countries have granted Mercosur members associate membership status and Mercosur has reciprocally granted CAN members associate membership. For both blocs, associate membership requires an intention to reach a free trade agreement (FTA), and political declarations in favour of forging a free trade area covering the two blocs were considered sufficient to meet this criterion. The two blocs signed an economic complementarity agreement in October 2004 as a step towards a FTA, which would

---

\(^3\) Mercosur’s ‘rules of origin’ prevent non-members countries from exploiting the continuing differences in import tariffs between members, requiring certain proportions of products to be manufactured within Mercosur countries to benefit from tariff-free trading terms between them.

\(^4\) Q151

\(^5\) 2005 population/GDP (US$) data from World Bank, World Development Indicator database, 2006


\(^7\) From Comunidad Andina; [www.comunidadandina.org/index.htm](http://www.comunidadandina.org/index.htm)

\(^8\) “Mercosur ‘must tackle inequality’”, BBC News Online, 19 January 2007: [news.bbc.co.uk/1/h/word/americas/6278307.stm](http://news.bbc.co.uk/1/h/word/americas/6278307.stm), and ‘Mercosur frustrates extension of Chavez influence’, Financial Times, 20 January 2007
reportedly eliminate tariffs between them within 15 years.\(^9\) However, UKTI told us that at present these FTAs do not mean a great deal in terms of market access.\(^10\) Chile, an associate of both blocs, has bilateral free trade agreements with each, although it is unclear whether its agreement with Mercosur has been put into effect.\(^11\) Also, Mexico currently has observer status within Mercosur, but is in the process of becoming an associate member. Our Report does not directly consider associate or observer Mercosur members, but useful data on these markets feature in the written evidence we received.\(^12\)

Figure 1: Trade blocs in South America & relationship with Mercosur

---


10 Appendix 28 (UKTI). UKTI note that while as a former member Venezuela currently has preferential access to CAN as well as Mercosur countries, currently the “other Mercosur countries do not benefit from preferential access to the Andean Market.” See, Appendix 26 (UKTI), paras 35 and 36.

11 ‘Chile Seeks To Strengthen Economic Ties with Mercosur’, Latin America News Digest (via Factiva), 11 April 2007. UKTI told us that the 1996 Mercosur-Chile agreement included staged tariff reductions for over 90% of products from October 1996, with exceptions for sensitive products up to 2014. See Appendix 26 (UKTI)

12 See Appendix 26 (UKTI), C4-C8
9. Like other regional blocs, including the EU and the North Atlantic Free Trade Agreement (NAFTA), Mercosur has significant asymmetries. The table below gives basic country data for the bloc’s members, illustrating the dominance of Brazil:

**Figure 2: Key data for Mercosur countries, 2005**

<table>
<thead>
<tr>
<th></th>
<th>GDP (US$ billion)</th>
<th>Population (millions)</th>
<th>Area (km²)</th>
<th>Goods trade (%GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>183.3</td>
<td>38.7</td>
<td>2,780,400</td>
<td>37.5</td>
</tr>
<tr>
<td>Brazil</td>
<td>794.1</td>
<td>186.4</td>
<td>8,514,880</td>
<td>24.7</td>
</tr>
<tr>
<td>Paraguay</td>
<td>8.2</td>
<td>6.2</td>
<td>406,750</td>
<td>53.7</td>
</tr>
<tr>
<td>Uruguay</td>
<td>16.8</td>
<td>3.5</td>
<td>176,220</td>
<td>40.8</td>
</tr>
<tr>
<td>Venezuela</td>
<td>138.9</td>
<td>26.6</td>
<td>912,050</td>
<td>58.4</td>
</tr>
<tr>
<td><strong>Mercosur total</strong></td>
<td><strong>1,141.2</strong></td>
<td><strong>261.4</strong></td>
<td><strong>12,790,300</strong></td>
<td><strong>43.0 (*)</strong></td>
</tr>
<tr>
<td><strong>Brazil as %</strong></td>
<td>69.6%</td>
<td>71.3%</td>
<td>66.6%</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: World Bank World Development Indicators 2006 database & TWB5L para 3 (Mercosur exports)
Notes: * average for Mercosur countries; - not applicable

10. As the CBI said, within Mercosur “one needs to divide out Brazil and the other countries.” Brazil is the largest country in Latin America, and the fifth most populous country in the world, after China, India, the US and Indonesia. It also has shared borders with ten other countries. It accounts for around 70% of the bloc’s total GDP, population, and area; prior to Venezuela’s membership Brazil was even more dominant, accounting for almost 80% of total GDP and population, and 72% of total area. Brazil accounted for around 72% of total Mercosur merchandise exports of $190 billion in 2006, and 66% of total Mercosur merchandise imports of $134 billion.

11. Argentina and Venezuela are medium-sized within the bloc, with broadly similar GDP levels, although Argentina has an area three times that of Venezuela, and half as many people again. Paraguay and Uruguay are comparatively small, together accounting for just over 2% of the bloc’s GDP, less than 4% of its population, and around 5% of its total area. Although Brazil has by far the largest economy in Mercosur, per capita GDP is higher in Argentina ($15,000, comparable with Eastern European countries Lithuania and Latvia)

---

13 Q 93
14 In 2005 based World Bank Population data from World Development Indicators database, July 2006
15 Appendix 10 (CBI), para 19
16 “Risks lie ahead following stronger trade in 2006, WTO reports”, WTO press release, 12 April 2007, appendix table 1
than in Brazil ($8,600). Uruguay has the second highest per capita GDP in the bloc ($10,700), with both Venezuela ($6,900) and Paraguay ($4,700) having lower per capita GDP than Brazil.17

**Institutions**

12. Mercosur has a six-month rotating presidency, currently held by Paraguay, with an administrative secretariat based in Montevideo, the Uruguayan capital.18 The bloc’s institutions include:19

— Common Market Council, of members’ foreign ministers, giving a political direction to integration;

— Common Market Group, the ‘executive branch’ managing integration, run by members’ officials, with working sub-groups;

— Trade Commission, to implement Mercosur’s common trade policy;

— Joint Parliamentary Commission and Economic and Social Consultative Forum, both consultative bodies to the Common Market Council;

— Dispute Settlement Court, established in 2004.

— The Mercosur Parliament, held its first monthly session on 7 May 2007 in Montevideo, the Uruguayan capital. The body is consultative only, with two 36-member chambers each with nine representatives drawn from the legislatures of Argentina, Brazil, Paraguay and Uruguay (due to its accession process Venezuela’s involvement is limited). Direct election is planned in the future.20

**Brazil’s economy**

13. Perhaps unsurprisingly given the economic crises that Brazil has experienced in the past—the contagion effects of the 1998/99 Asian financial crisis, a collapse in investor confidence and a mass investment withdrawal followed by devaluation of the Brazilian Real in January 1999—stability rather than high growth has been the economic policy priority. Brazil is in a stronger economic position today than in its recent past, having successfully maintained macroeconomic stability with consistent growth. UKTI noted that Brazil has seen “consolidated macro stability built upon the pillars of a strong primary budget surplus, a flexible exchange rate and a non politicised, although not officially independent, central bank.”21 Although the target for annual growth has been 4-4.5% the

---

18 British Chambers of Commerce in Brazil, Doing Business in Brazil, 2005, pp 319-320
21 Appendix 23 (UKTI), annex A
Brazilian economy grew by 2.9% in 2006. A plan which aims to increase growth to 5% was announced earlier this year and is discussed below.

14. While this level of growth is broadly comparable with those seen in Western Europe, it has consistently been below that of the other BRIC economies, and is projected to continue to be below those countries’ growth levels:

**Figure 3: Output (annual percentage changes), BRIC countries**

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007 (proj.)</th>
<th>2008 (proj.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil (*)</td>
<td>2.9</td>
<td>3.7</td>
<td>4.4</td>
<td>4.2</td>
</tr>
<tr>
<td>Russia</td>
<td>6.4</td>
<td>6.7</td>
<td>6.4</td>
<td>5.9</td>
</tr>
<tr>
<td>India</td>
<td>9.2</td>
<td>9.2</td>
<td>8.4</td>
<td>7.8</td>
</tr>
<tr>
<td>China</td>
<td>10.4</td>
<td>10.7</td>
<td>10.0</td>
<td>9.5</td>
</tr>
</tbody>
</table>

Source: IMF, World Economic Outlook, April 2007, table 1.1
Note: Data reflect recent revisions to Brazil's GDP statistics

Despite this, Brazil has the second highest total GDP among emerging markets after China, and higher per capita GDP than either China or India.

15. Brazil’s recent growth has been led by exports, with major products including metallurgical products and soybeans; and trade as a proportion of Brazil’s GDP has risen to 26% in 2004 from 13% in 1996. There were both fiscal and current account surpluses in 2005. Inflation has also been brought under control, down from 16.0% in 1996 to 6.9% in 2005. Brazil’s “sovereign debt risk has fallen to record lows”, and its stock market was the seventh best performer globally in 2005 with gains of 60%. Past external debt-related problems have led Brazil to focus on paying off its external debt, repaying both its entire $15.5 billion debt to the International Monetary Fund in December 2005 and its Paris Club debts.

---

22 Appendix 23 (UKTI), para 1.1, and Appendix 11 (CBI), para 6
23 These revisions saw real GDP growth revised upwards from a 2002-06 average of 2.5% to 3.25% (IMF, World Economic Outlook, April 2007, Box 2, p6)
24 Appendix 23 (UKTI), para 1.2, and Appendix 10 (CBI), para 6
25 Appendix 23 (UKTI), para 1.3
26 Appendix 23 (UKTI), annex A
27 On the JP Morgan Emerging Market Bond Index measure, which tracks the price of dollar-denominated bonds, and “foreign exchange linked debt has been eliminated.” See Appendix 23 (UKTI), annex A.
28 Appendix 23 (UKTI), annex A
29 The IMF has noted that “favourable external conditions have allowed the central bank to build up international reserves and reduce external debt to its lowest ratio to exports in more than 25 years” (IMF Survey 24 July 2006)
16. Elected in 2000 and recently re-elected for a second term running until the end of 2010, President Lula da Silva has confounded some critics of his political stance. UKTI said Brazil was pursuing an “economic third-way between outright populism or ‘leftism’ in the Chavez or Castro mould” and “full-blooded capitalism embodied by the US”.30 There “have been some doses of nationalism”, but these have been “the exception rather than the norm.”31 While there has been “a greater emphasis on social justice goals”—creating jobs, reducing poverty by raising the incomes of the poor, and reducing hunger—this “has not hinged on economic intervention, but rather on solid economic policies and subsequent growth (particularly in government revenues).”32 Poor families have benefited from cash transfers for healthcare and education services from the Bolsa Família (Family Grant) programme, meeting its target of reaching 11 million families (45 million people) as of June 2006,33 making it “one of the largest social transfer programmes in the world”.34 The minimum wage has also been increased (as have public pensions, which are linked to the minimum wage). These policies have seen estimates of poverty levels on some measures fall from 28% of the population in 2003 to 23% in 2005.35

17. Nevertheless, concerns continue to be expressed about the Brazilian economy. Brazil has a comparatively high tax burden by developing country standards, and comparable with developed countries, which is widely seen as stifling growth. The tax burden on business in Brazil is 36% of GDP, higher than in India, Mexico, Russia and Turkey, and more than double that of China (17% of GDP).36 UKTI called the quality of fiscal structure the “key macroeconomic challenge” for Brazil, with “implications for all aspects of the economy”.37 This issue, among others, is examined further in Chapter 3.

18. Brazil is also accused of continuing underinvestment in infrastructure. The CBI told us that less than 25% of Brazil’s roads could be considered good, that its railways needed modernisation, and that investment was needed in ports, roads, and electricity production and transmission.38 The World Bank has said that while Brazil is currently investing 1% of GDP into infrastructure, it needs to invest 3.2% to avoid further deterioration of structures and services.39 The Financial Times also noted that at less than 3% of GDP Brazil’s capital investment levels were “well below the commitments being made by more rapidly growing countries in Asia”.40 The Economist has talked of Brazil’s ‘Stockholm syndrome’—“a love

30 Appendix 23 (UKTI), annex A
31 Ibid.
32 Ibid.
33 World Bank, Brazil country brief, July 2006; http://go.worldbank.org/UW8ODN2SV0
34 FCO, Latin America to 2020 a UK Public Strategy Paper, Box 8 ,p16.The programme brought together a number of schemes to reduce poverty, and gives R$95 a month if children participate in school and vaccinations.
35 ‘Love Lula if you’re poor, worry if you’re not’, The Economist, 28 September 2006 citing data from the Getulio Vargas Foundation
36 Appendix 23 (UKTI), annex A
37 Ibid.
38 Appendix 10 (CBI), para 23
39 ‘Brazil “must lift barriers” to new infrastructure’, Financial Times (ft.com), 28 February 2007 (this assumes annual growth of 2%)
40 ‘Left turn ahead? How flaws in Lula’s plan could condemn Brazil to lag behind its peers’, Financial Times, 22 February 2007
for a state that holds the economy hostage”, and has recommended reducing the size of the state, increased investment, improved education services, formal independence for Brazil’s Central Bank, reduced import tariffs, and tax simplification.\textsuperscript{41} A McKinsey report suggested that Brazilian growth could be raised to 7\% with a national commitment to reform and a long-term economic vision that would address the size of Brazil’s informal economy, reduce government consumption, reform judicial and public services, and develop infrastructure.\textsuperscript{42}

**The five year growth plan**

19. On 22 January 2007, President Lula da Silva announced an *Acceleration Programme for the Country’s Growth* (known as the PAC) to raise growth to 5\% by 2008. This will see £121 billion (504 billion reais\textsuperscript{43}) of investment from 2007-2010 on infrastructure including roads, ports, electricity generation, and housing. The PAC also includes: tax incentives for investment, with £1.5 billion (R$6.6 billion) of tax cuts in 2007 and around £2.8 billion (R$11.5 billion) from 2008 targeted at “construction, infrastructure and small businesses”; simplification of business registration; streamlined issuing of environment licences; limits on the growth of public spending through a cap on the minimum wage (and therefore on Brazil’s public pensions) to rise with inflation and economic growth, and a cap on government wages to inflation plus 1.5\%; and also a forum to look at pension reform.\textsuperscript{44}

20. The *Financial Times* noted that public investment in the plan was driven by the hope that it would stimulate private sector investment through tax breaks for construction and water and other infrastructure spending.\textsuperscript{45} The *Economist* called the PAC “overly timid”, arguing that much of the expenditure announced in the plan had previously been planned, and that it failed to tackle “the cause of low growth: excessive spending and debt, which depress investment by keeping taxes and interest rates high”, and tax and social security complexity.\textsuperscript{46} The *Financial Times* also noted that the PAC would not address the “bankrupt pensions system and spiralling government spending”.\textsuperscript{47} There was, however, some support for the PAC as a means to ensure economic stability in Brazil.\textsuperscript{48}

\textsuperscript{41} ‘Lula the political prizefighter - Brazil’s presidential election’ *The Economist*, 28 October 2006, and ‘Love Lula if you’re poor, worry if you’re not’, *The Economist*, 28 September 2006. To reduce public spending and net debt in the long-term it called for the link between minimum wages and pensions to be broken, while accepting that as this was entrenched in Brazil’s 1988 constitution this would be difficult, requiring constitutional amendments with 60\% support in both the Chamber and the Senate of the Brazilian Congress.


\textsuperscript{43} Reais is the plural of real, the Brazilian currency, which is often abbreviated to R$.

\textsuperscript{44} ‘Stirred, but not shaken up - Brazil’s economy’, *The Economist*, 27 January 2007, see also ‘Lula pins hopes on economic plan’, *BBC News Online*, 23 January 2007 and ‘Measures launched to boost Brazil’s economic growth’, *Financial Times*, 23 January 2007

\textsuperscript{45} ‘Left turn ahead? How flaws in Lula’s plan could condemn Brazil to lag behind its peers’, *Financial Times*, 22 February 2007

\textsuperscript{46} It said only R$1.4 billion of tax relief was new, and that federal government investment was only 13\% of the total, with the rest coming from state-controlled companies and the private sector. (‘Stirred, but not shaken up - Brazil’s economy’, *The Economist*, 27 January 2007)

\textsuperscript{47} ‘Measures launched to boost Brazil’s economic growth’, *Financial Times*, 23 January 2007

\textsuperscript{48} ‘Stirred, but not shaken up - Brazil’s economy’, *The Economist*, 27 January 2007
21. The Trade Minister told us that, while the UK Government supported the PAC and would work with the Brazilian Government, the two had held discussions over prioritisation within it. Noting that the political situation in Brazil was key to its implementation, the Trade Minister said that the UK Government “would like them to take on the two themes of investment in infrastructure and incentives to and encouragement of private sector investment, looking to the creation of public/private partnerships and dealing with procurement issues and financial services.” The Brazilian government minister responsible for the PAC has recently suggested that there is a risk that a number of its targets could be missed: out of 1,646 measures, 53% were on track and 39% needed attention, with the remainder giving “cause for concern”. The last includes two hydroelectric dams, where there have been problems with the granting of environmental licences.

Brazil: A BRIC in the wall?

22. As noted above, our inquiry is one of a series into the key emerging markets, the ‘BRICs’. With origins in a 2001 Goldman Sachs report, the acronym gained broader recognition though a 2003 paper extending the previous 10-year forecast analysis to 2050. This found these four countries had the potential to be among the world’s seven largest economies by 2050, with Brazil’s economy having the potential to eclipse Italy’s by 2025, France’s by 2031, and those of the UK and Germany by 2036. When Goldman Sachs reassessed the BRICs’ progress in 2005 it found that China could be the world’s largest economy by 2050, India third (behind the US), Brazil fifth (behind Japan), and Russia seventh (after Mexico), with the UK in ninth place. Of a ‘Next 11’ of other major developing countries that was examined only Mexico and South Korea were thought to have the potential to be as important as the BRICs.

23. There have been suggestions that the BRIC acronym has origins in convenience rather than reality, or that it is a re-branding of what were formerly merely emerging markets following the economic crises of the 1990s. Goldman Sachs state that:

“We did not include Brazil and Russia purely because the acronym would fail to be made if we left them out, as we have repeatedly and amusingly heard. We genuinely

49 Q162
50 Ibid.
52 Confusingly, the acronym BRICS, rather than BRICs with a small ‘s’, is often used for the four countries plus South Africa, although the original reports did not group South Africa with the others.
56 Ryst, S. ‘How sturdy are BRICs’, Business Week, 31 May 2006; http://www.businessweek.com/investor/content/may2006/pi20060531_214570.htm?chan=globalbiz_europe_more+of+today+s+top+stories
believed, and still do, that these two economies, along with China and India, have the potential to be among the most interesting global economic stories and investment themes for many years to come. In addition, we now believe even more strongly that optimal economic policymaking cannot be undertaken without including all of the BRICs countries at the highest level.” 57

24. However, some maintain that grouping these countries masks the significant differences between them; as the Trade Minister acknowledged, the BRICs “have their own differentiations in terms of growth, size of market, size of labour force and the sectors where they concentrate their efforts”. 58 He said that while each had its own barriers to trade and investment, “One thing that unites them all is that they will be substantial growth areas, not just in the next five years but for decades to come.” 59

25. Recent debate has heavily focused on China and India, dubbed “Chindia”, 60 rather than on Brazil or indeed Russia. For some the emergence of China and India is bringing “a real shift in the power balance”, Russia and Brazil “are marginal economies propped up by high commodity prices” and undermined by a lack of long-term investment. 61 A recent City of London report noted that the BRICs are very different from each other: Brazil supplying raw materials to the world, and having an expanding population; Russia’s energy reserves vital to world energy markets, though with a shrinking population. 62 Meanwhile China and India were “transforming not only the dynamics of the world economy, but also the balance of power”, and “poised to be the drivers of a potential new centre of economic gravity, covering the whole of Asia”. 63 In particular, Brazil’s comparatively slow rate of economic growth of 2–3%, “lethargic” 64 compared with the breakneck growth rates seen in India and China, has led some to question its right to be a member of the same club as the other BRICs. Other terminology has been proposed, including ‘CHIME’ (China, India and the Middle East), 65 ‘CIBS’ (China, India, Brazil and South Africa), 66 and even ‘CEMENT’ (Countries in Emerging Markets Excluded by New Terminology)—as “if you want to build a wall, you need both bricks and cement”. 67
26. However, Brazil has recently seen rising growth, a doubling of exports since 2003, falling interest rates, more manageable public debt, and reductions in income inequality, and poverty.\textsuperscript{68} \textit{The Economist} also noted that “in many ways Brazil is the steadiest of the BRICs”, with democracy and no serious disputes with neighbours, and that its slower growth could be explained by being richer and more urbanised than the other BRICs.\textsuperscript{69}

27. Moreover, although Brazil’s progress may not be as spectacular as that of China and India, its importance as an economic power should not be underestimated: in 2005 Goldman Sachs estimated that Brazil could overtake the GDP of Italy, France, Germany and the UK by 2040.\textsuperscript{70} In a further reassessment of BRICs’ progress in December 2006, Goldman Sachs said that they “remain confident” about Brazil’s potential for growth, and that President Lula’s second term would “sustain sound macroeconomic policies and make some progress on structural reforms” with real GDP growth of around 3.5%. As this is consistent with their estimate of the BRIC countries’ potential growth rate (3.7%), they concluded that “Brazil does belong in the BRICs”.\textsuperscript{71}

28. As the Trade Minister remarked, Brazil is “not an India or China, but in terms of the global economy and its growth and where it is geo-politically set in Latin America it is a major global player and is seen and treated as such by the World Bank, IMF, stock exchanges and big investors around the world.”\textsuperscript{72} He also said that the different challenges facing each of them meant that he was “not quite sure that the concept of a synergy between them is the right way to go. We have to treat all of them as massive markets with different barriers but also great opportunities, and we need to deal with them differently.”\textsuperscript{73} UKTI noted that “even if Brazil is not meeting the globalisation challenge in a manner comparable to China and India, one must not lose perspective about its place in the world.”\textsuperscript{74}

29. Throughout our inquiry, the critical importance of market knowledge of Brazil, and to a certain extent the other Mercosur countries, was repeatedly emphasized. We also heard of a persistent ‘perception lag’ after past economic and political problems in Latin America, even that UK businesses have a blind spot for the continent. The general lack of knowledge about Brazil and the other Mercosur markets contributes to the perception that they are simply ‘too difficult to do business with’. \textbf{Lack of knowledge and outdated perceptions among UK businesses appear to us to be the main reasons underlying the lack of UK engagement with Brazil compared with our competitors. We have seen many examples of opportunities in Brazil and the rest of Mercosur that could be exploited, and indeed are being exploited by competitors. We hope that by raising awareness of both the

\begin{flushleft}68 \textsuperscript{[Leader] ‘Should try harder’, \textit{The Economist}, 14 April 2007, p14
69 ‘Land of promise’, \textit{The Economist}, 14 April 2007, p4
70 Goldman Sachs, ‘How Solid are the BRICs’, \textit{Global Economics Paper 134}, 2005, appendix 4, p20
72 Q161
73 \textit{Ibid.}
74 Appendix 23 (UKTI), annex A\end{flushleft}
opportunities and risks involved in these markets, this Report and its supporting evidence will make a useful contribution to those companies who are considering trading with or investing in Brazil, Argentina and the other Mercosur countries.
2 Brazil & the UK

UK-Brazil trade & investment relations

30. Brazil is the UK’s most important trade partner in Latin America. With total UK goods exports to Brazil valued at £836 million, it was the 35th largest export market in 2005, and with imports valued at £1,739 million Brazil was the 32nd largest import source. Brazil accounted for 0.4% of total UK exports in 2005, a much lower share than for the other BRICs, although slightly above that for Mexico; the picture is similar for imports:

Figure 4: BRIC countries plus South Africa & Mexico – Shares of UK imports & exports, 2005

<table>
<thead>
<tr>
<th>Country</th>
<th>% of total UK exports</th>
<th>% of total UK imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>China</td>
<td>1.3</td>
<td>4.6</td>
</tr>
<tr>
<td>Russia</td>
<td>0.9</td>
<td>1.8</td>
</tr>
<tr>
<td>India</td>
<td>1.3</td>
<td>1.0</td>
</tr>
<tr>
<td>South Africa</td>
<td>1.0</td>
<td>1.4</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.3</td>
<td>0.2</td>
</tr>
</tbody>
</table>


31. In 2005 Brazil’s main sources for imported goods were the US ($15.3 billion), Germany ($6.7 billion), Argentina ($6.4 billion), China ($4.8 billion), and Nigeria ($4.8 billion). The UK is Brazil’s 13th largest source for imports, down from 9th in 2003. As the Trade Minister said “We have only about a 2% penetration in this marketplace” — “ridiculously low” given its capacity.

32. Around 92% of UK exports to Brazil are manufactured goods, with main products including: organic chemicals, pharmaceuticals, power generating equipment, scientific instruments, electrical machinery and road vehicles. Imports from Brazil were primarily of meat, animal foodstuffs, pulp and paper, footwear, cork and wood manufactured goods,

---

76 Ibid.
77 Appendix 23 (UKTI), annex C
78 Appendix 23 (UKTI), para 4.1
79 Q 158
tobacco, power generation machinery, and vegetables and fruit. Among EU countries the UK ranked 4th for exports in 2005 behind Germany (whose exports were almost 4.5 times those of the UK), France and Italy.

33. The stock of foreign direct investment into Brazil increased from $103 billion in 2000 to $200 billion in 2005. The UK had the 4th largest foreign direct investment (FDI) stocks in Brazil as at the end of 2003, behind France, the Netherlands, and Germany. FDI from the UK is concentrated in a small number of relatively large investments, which include HSBC, Cadbury, ICI and British Gas. In 2005 the UK accounted for 0.7% of total FDI inflows behind the US (21.5%), France (6.7%), Germany (5.9%) and Japan (3.6%). However, UKTI told us that while “UK investment appears low it is likely that the real figure is much higher. British companies investing in Brazil often invest through third countries typically the Netherlands” and that the Netherlands’ investment figures for Brazil were “unrealistically high.”

34. It is unclear whether this situation reflects substantial investments from Shell and Unilever in Brazil which are attributed to the Netherlands rather than the UK, or whether companies are opting to invest via the Netherlands perhaps to take advantage of double taxation arrangements it has with Brazil, which the UK does not share. The British Chambers of Commerce in Brazil noted that while the Netherlands was the second largest source of FDI from 2000—2004, it did not “appear to have strong cultural, language or historical ties with Brazil”, but while the British Chambers suggested that taxation agreements could be driving high levels of investment, they only specifically referred to the strong performance of the Cayman Islands, the British Virgin Islands and Bermuda. UKTI said that the reasons behind the route of investment by UK multinationals were varied, and “not always tax related”, stating that HM Revenue & Customs was not aware that investment in Brazil is being channelled through any one EU state (such as the Netherlands) as a result of a particular tax treaty. The double taxation agreement issue was highlighted by a number of witnesses, including the CBI, the British Chambers of Commerce in Brazil and UKTI, and again in the bilateral JETCO process. During our visit we were also told of UK businesses that had invested via Italy in order to benefit from the better tax situation. We find it difficult to believe, therefore, that this is having no effect on statistics regarding UK investment in Brazil. Progress towards the JETCO priority of a double taxation agreement issue is discussed in Chapter 3 below.

---

80 Appendix 23 (UKTI), para 4.2
81 The UK is also ranked 4th on imports after Germany, the Netherlands and Italy. See Appendix 23 (UKTI), annex C
82 UN World Investment Report 2006, Brazil fact sheet
83 Appendix 23 (UKTI), para 4.6
84 Appendix 23 (UKTI), para 4.5, citing Brazilian Central Bank data. The British Chambers of Commerce in Brazil told us that the biggest investors in Brazil between 2000 and 2004 were the US, followed by the Netherlands, Spain, with Portugal in 7th, and the UK in 15th, behind Luxembourg, the British Virgin Islands, Bermuda, and the Cayman Islands. See Appendix 6 (British Chamber of Commerce in Brazil), p 7.
85 Appendix 23 (UKTI), para 4.6; Q16 notes that “Shell’s investment goes under the Netherlands’ outward investment figures.”
86 Appendix 6 (British Chamber of Commerce in Brazil), part 2.2.2
87 Appendix 27 (UKTI), annex M
Brazil: The challenge for UK companies

35. We have learned that Brazil is a challenging market: there are significant opportunities, but not without significant barriers. These are explored in more detail in Chapter 3. The CBI told us that while Brazil has market size, natural resources, stable government and a healthy macro-economic climate it was “not the easiest market in which to do business and, in common with other emerging economies, companies need to be aware of these dynamics in order to execute a successful market strategy.” UKTI told us that Brazil has significant bureaucracy, constantly changing regulations, and complex tax and labour laws, but that Brazil also has a motivated work force and developing export-focused labour intensive industries.

36. The World Bank ranked Brazil 121st out of 175 countries on ease of doing business in 2006, having ranked it as 122nd in 2005. Among the various areas considered in this measure Brazil ranked best on trading across borders (53rd), protecting investors (60th) and getting credit (83rd), and worst on paying taxes (151st), dealing with licences (135th), enforcing contracts (124th) and starting a business (115th). As regards investment, AT Kearney’s FDI confidence index, which measures the likelihood of making investments in particular markets, ranked Brazil 7th at the end of 2005, behind China (1st), India (2nd) and Russia (6th). However, the Economist Intelligence Unit ranked Brazil 44th on the quality or attractiveness of business environment in its World Investment Prospects for the period 2006-2010, comparing it favourably with the other BRICs, with China ranked 51st, India 58th, and Russia 59th.

37. However, while in general the same barriers face all foreign companies doing business with Brazil, the UK appears to be underperforming compared with its competitors: UKTI said that “our performance in Brazil is less impressive than it should be. I do not think there is any doubt about that.” The Trade Minister followed this by saying: “I believe that the time is now overdue for us to up our game.” UKTI also spoke of “something of a blind spot” that British industry has had on Latin America. The CBI spoke of a “perception gap or lag” or “perception legacy” about Brazil, what one could call a ‘South American stigma’ which, while not borne out by the economic reality, affects decisions, as “One tends to make a decision based on one’s perception of reality.”

88 Appendix 10 (CBI), para 3
89 Appendix 23 (UKTI), para 2.1
91 Ibid.
93 Economist Intelligence Unit, World Investment Prospects to 2010, table 14, p38
94 Q 6
95 Q 157
96 Q 69
97 Appendix 10 (CBI), Qq 108 and 98
38. UKTI suggested that existing cultural relationships—long-standing links with Germany, Japan, Italy and France, for example—have their effect.\(^{98}\) UKTI noted that, as we had also seen in India, “British companies can be quite risk averse to markets like Brazil and that may be a difference between British companies and companies in Germany, France or elsewhere.”\(^{99}\) They said that Brazil was “very distant”, and that “British companies feel that there are easier fish to fry”, with a “general perception amongst British companies that doing business with Brazil can be quite problematic”, with “a range of reasons why companies perhaps do not look at Brazil as positively as they ought to do.”\(^{100}\)

39. UKTI also told us that Brazil is an exception within the region, standing alone on the strength and size of its economy (the world’s 11th largest) and being Portuguese-speaking, and that the experience of working with other markets would probably not give companies as much knowledge and understanding of doing business in Brazil as they may wish.\(^{101}\) The Director of Europe and the Americas at UKTI suggested that Brazil:

> “is so different from other markets that it poses a challenge to British companies. I often feel that if Brazil were taken out of Latin America and put down in some other part of the globe, British companies might well be better able to tackle the market and tackle the challenges of it. It seems to me that is the part of Latin America which British industry has had a blind spot on for many years. That is not how it used to be, of course, because many British companies were pre-eminent in Latin America.”\(^{102}\)

40. There are, of course, notable UK success stories in Brazil, including HSBC and Cadbury among others. There is a well established British Chamber of Commerce in Brazil (Britcham) with trade and investment committees in São Paulo, Rio de Janeiro and Porto Alegre.\(^{103}\) The CBI also had some grounds for optimism, seeing increased inquiries about and interest in Brazil, and a greater willingness to look at the opportunities offered by the Brazilian market in the past 2—3 years, hence the “upbeat tone” of their evidence.\(^{104}\) The CBI added that, unlike 10 or 15 years ago, “we are now seeing a group of managers coming through into the top and upper echelons of British business who have had experience of working in the region […] So you are now seeing people who understand the region, understand the dynamics and, therefore, in the sort of inquiries and conversations we have with our member companies, we believe there is an increasing degree of seriousness and reality about the conditions in Brazil.”\(^{105}\)

41. As UKTI said: “Compared to the media attention given to other rapidly developing economies such as China and India, Brazil suffers from outdated stereotyping and poor

---

\(^{98}\) Q 158  
\(^{99}\) Q 6  
\(^{100}\) Q 2  
\(^{101}\) Q 69  
\(^{102}\) Q 71  
\(^{103}\) Appendix 6 (British Chamber of Commerce in Brazil), para 1.4  
\(^{104}\) Q 108  
\(^{105}\) Q 98
knowledge. UKTI and other agencies could help importantly to fill this knowledge gap.” We agree.

**UK Trade & Investment (UKTI) in Brazil**

42. Brazil is benefiting from the new UKTI strategy, which—backed with £5 million of funds in total—switches focus from mature markets to key emerging markets. The Government has stated that UKTI’s corporate strategy now recognises Brazil as a growth market that presents both opportunities and challenges for UK companies. The Trade Minister told us that under the new strategy he had been keen “to ensure Brazil was one of the countries in our champions’ league of increased investment.” He said that UKTI would now be better at providing support to UK companies that wish to trade, inwardly invest or seek a partner for trade or investment. We have explored the new strategy in a parallel inquiry, although this Report has given us a practical case study of its impact. The consequences of the new strategy more widely across Mercosur are discussed in Chapter 6.

**Resources**

43. The CBI told us that UKTI has a “very good team focussing on Brazil”. Also, the University of Birmingham’s study into Small and Medium-sized Enterprises (SMEs) and Brazil found that companies coming new to Brazil appreciated that UKTI and its country-based staff were able to provide a first-hand analysis of business opportunities there, and help them to develop business contacts. UKTI’s Brazil team comprises approximately 32 people in São Paulo, Rio de Janeiro, Brasilia, Porto Alegre and Recife, and three full-time London-based staff. Expenditure on sector-based activities related to Brazil—trade missions, exhibitions, seminars, etc.—was £365,000 in 2004/05 and £490,000 in 2005/06, but was down to £288,000 (provisional) in 2006/07. The 2004 Spending Review resulted in UKTI offices in Belo Horizonte and Curitiba (both in the southwest of the country) being closed with the loss of four local jobs. Under UKTI’s new strategy, resources in Brazil will increase by six posts from 2005/06 levels over the course of 2006/07 and 2007/08. These will be made up of:

106 Appendix 29 (University of Birmingham), para 13
107 Appendix 23 (UKTI), para 6.27. In 2006/07 staff resources were increased in Brazil, China, Hong Kong, Taiwan, India, Dubai, Mexico, Qatar, Saudi Arabia, Turkey, Vietnam and Russia. Staff decreases were seen in Australia, Canada, Finland, France, Germany, Ghana, Hungary, Ireland, Italy, Japan, Kuwait, Nigeria, Philippines, Poland, Senegal, Spain, Sri Lanka, Sweden, Uganda, the US, Uruguay and Zimbabwe (HC Deb, 2 February 2007, col 582W).
109 Q 157
110 Ibid.
112 Appendix 10 (CBI)
113 Appendix 29 (University of Birmingham)
114 Appendix 23 (UKTI), paras 6.31 and 6.32
115 Ibid., and para 6.33
— two locally engaged São Paulo-based inward investment posts (see below);

— three UK-based trade posts (meaning an official from the UK on a long-term posting in the market) in Brasilia (working mainly on the Joint Economic and Trade Committee, or JETCO, as discussed in paragraphs 83-87 below), Rio de Janeiro (focusing on oil and gas), and São Paulo (to develop business opportunities in priority sectors); and

— one local trade post in Rio de Janeiro.116

44. Brazil compares unfavourably with both India and China on the number of UKTI commercial officers. We acknowledge, but do not fully share, the CBI’s view that, for UKTI generally “an excessive concentration of resources on China and India could lead to missed opportunities elsewhere”.117 There have also been fewer officers in Brazil than in the Gulf States, although this situation will reverse in the current financial year (2007/08):

Figure 5: UK Trade and Investment commercial officers

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>51.1</td>
<td>39.1</td>
<td>39.0</td>
<td>42.0</td>
<td>45.0</td>
<td>45.0</td>
</tr>
<tr>
<td>China</td>
<td>87.7</td>
<td>94.6</td>
<td>98.8</td>
<td>106.1</td>
<td>113.0</td>
<td>113.0</td>
</tr>
<tr>
<td>India</td>
<td>81.3</td>
<td>76.1</td>
<td>76.3</td>
<td>80.3</td>
<td>91.3</td>
<td>91.3</td>
</tr>
<tr>
<td>Russia</td>
<td>17.2</td>
<td>17.9</td>
<td>16.0</td>
<td>20.0</td>
<td>26.5</td>
<td>26.5</td>
</tr>
<tr>
<td>Gulf States</td>
<td>46.9</td>
<td>46.4</td>
<td>41.3</td>
<td>45.5</td>
<td>43.3</td>
<td>43.3</td>
</tr>
</tbody>
</table>

Source: HC Deb, 11 Dec 2006, col 810W (rounded)

45. We welcome the positive contribution of the new UKTI strategy on resources committed to the Brazilian market. We note, however, that these resources have only partially reversed the decline seen after the 2004 Spending Review and the closure of UKTI’s regional offices in Brazil, and that these remain more than 10% below the level seen in 2003/04.

46. With its apparent image problem among UK businesses, UKTI noted that trade visits to Brazil have made “some of the preconceptions disappear”, with nine trade missions last year.118 While SMEs had been a major focus of the attention of UKTI as a whole in recent years, UKTI’s Brazil team had recognised that this was a difficult market for many SMEs, and so had looked at larger companies.119 The CBI also said that Brazil was “not going to be

116 Appendix 27 (UKTI), Annex O
117 Appendix 10 (CBI), para D25
118 Appendix 27 (UKTI), annex R
119 Q 8
a destination that new-to-export companies would be looking at, or necessarily an ‘S’ of the ‘SME’”. Brazil, in common with the other BRICs, was more for the experienced exporter able to manage the risks involved. We were also told that UKTI is taking on fifteen business advisors to focus on medium-sized companies that have the potential to succeed in the emerging markets, including Brazil. The Trade Minister agreed that the Brazilian market was more suitable for larger investors, but said that opportunities remained for small investors and SMEs, noting that a UKTI priority was to work with such companies to secure market access directly in emerging economies directly through partnerships or other activities. Classed as an emerging market by UKTI, Brazil is now eligible for market visit support—financial assistance for new-to-export and new-to-market SMEs. The University of Birmingham SME and Brazil study concluded that UKTI should work to increase awareness of opportunities in Brazil, and prioritise SME access to relevant networks in Brazil and the UK while generally reducing confusion among SMEs about accessing UKTI services.

Brazil is unlikely to be a market that presents immediate or easy wins for SMEs, and we therefore agree that medium-sized and large companies should be the focus of UKTI support for this market. However, the experience of our EU competitors shows that it is possible to open up opportunities for smaller companies as part of the supply chain for larger companies breaking into the Brazil market. We would welcome more emphasis on this area in UKTI’s work. Moreover, where niche companies are looking to trade with Brazil or opportunities for smaller companies present themselves, UKTI should provide them with the necessary support and information.

Priority sectors

47. UKTI’s sector teams are setting a maximum of five priority markets in each sector across the world for 2007/08 on which to concentrate. Up to a further seven more ‘opportunity markets’ will get “one key activity during the financial year”. The priority markets are based on factors such as the level of opportunity, the need for government support, their fit with the UK’s strengths, and industry views, and are subject to annual review. The only sector in which Brazil is a global priority market is oil and gas, while the only other priority in Mercosur is Venezuela, also in oil and gas.

48. As well as taking a global view, UKTI determines its priority sectors within markets. For 2007/08 Brazil’s priority sectors are: agriculture, engineering, environment, healthcare and life sciences, oil and gas, sports and leisure infrastructure, and chemicals. Two

120 Q 107
121 Appendix 27 (UKTI), annex R
122 Q 164
123 Appendix 23 (UKTI), para 6.6 and Appendix 27 (UKTI), annex R
124 Appendix 29 (University of Birmingham), para 12
125 Appendix 27 (UKTI), annex I
126 Ibid., and Q 39
127 Q 168 & Appendix 27 (UKTI), annex I
priority sectors from 2006/07 have been downgraded: education skills and leisure, and textiles and carpets. The opportunity sectors in Brazil for 2007/08 are: aerospace, construction, creative and media, education and skills, financial services, and ports.\textsuperscript{128} We consider the opportunities available for UK companies by sector in Chapter 3.

49. We generally agree with the selection of the seven priority sectors (agriculture, engineering, environment, healthcare and life sciences, oil and gas, sports and leisure infrastructure, and chemicals) and six opportunity sectors (aerospace, construction, creative and media, education and skills, financial services, and ports) selected by UKTI for 2007/08. However, given Brazil’s BRIC status it is perhaps surprising that only one sector—oil and gas—is considered a global priority. It is also unclear why two out of the three strategic sectors identified bilaterally as part of the JETCO process\textsuperscript{129} during 2006/07—aerospace and financial services—are only UKTI opportunity sectors for Brazil in 2007/08. We examine the UK’s involvement in the financial services sector later, but we hope that the UKTI sector strategies currently under development (covering ICT, life sciences, creative industries and energy) will reflect the due importance of Brazil alongside the other BRICs, particularly China and India.

\textit{Inward investment from Brazil}

50. The Trade Minister told us that there had been only £77 million of inward FDI from Brazil into the UK, “such a small sum you cannot identify specific projects”, although all in the financial services sector, and contrasted this with the £500 million of Indian inward FDI last year.\textsuperscript{130} However, the Economist Intelligence Unit states that Brazilian companies had been leading in foreign investment among emerging markets for some time, and that Brazilian companies that have foreign interests employ 42,000 workers in 48 countries.\textsuperscript{131}

51. UKTI told us of increased interest during 2006 in the UK as a destination for Brazilian investment, for example through establishing European headquarters in the UK.\textsuperscript{132} ThinkLondon, the capital’s investment agency, told us that its strategy reflected the relative immaturity of Brazil as a source of FDI compared with India and China, where it has established offices. It nevertheless accepted the potential of Brazil, noting that there were at least twenty large Brazilian companies with a London presence, and also recent interest from the telecommunications and cosmetics sectors. ThinkLondon said that it believed a long-term base in São Paulo in partnership with UKTI to be the best approach.\textsuperscript{133} The new inward investment posts based in that city, part of the increase in UKTI resources over the course of 2006/07 and 2007/08, should help to increase Brazilian interest in investing in London.

\textsuperscript{128} Appendix 27 (UKTI), annex I
\textsuperscript{129} See paragraphs 83-87 below, and 96-115 for sectors.
\textsuperscript{130} Q 161
\textsuperscript{131} Economist Intelligence Unit, World Investment Prospects to 2010, p42 (Box)
\textsuperscript{132} Appendix 23 (UKTI), para 6.21
\textsuperscript{133} Appendix 22 (Think London)
Activity of UK countries/regions in Brazil

52. UKTI was not aware of any physical presence of the English Regional Development Agencies (RDAs) in Brazil.134 We were presented with evidence of some significant regional activity regarding Brazil, arranging visits and so on.135 UKTI also pointed out matches between its priority and opportunity sectors and Scottish Enterprise’s priority industries: energy, financial services, life sciences, electronic markets, food and drink, and tourism.136 International Business Wales, the Welsh Assembly Government’s trade and investment body bringing together the former responsibilities of WalesTrade International and the international aspects of the Welsh Development Agency, has visited Brazil four times since the Welsh Assembly Government was created.137 We have previously raised concerns about unhelpful competition between the English Regional Development Agencies, and the vital need for co-operation between UKTI and them. We were therefore relieved to hear that these bodies do not have permanent on-the-ground presence in Brazil, and there is little sign of damaging competition between them in their Brazil-related activities.

134 Q 86 and 87
135 Appendix 27 (UKTI), annex R (UKTI regional activity is outlined in appendix 23, annex H). The East Midlands Development Association was to support a São Paulo visit in March 2007 by thirty company representatives from the biomedical, creative Industries and engineering sectors (HC Deb, 25 Jan 2007, col 1965W).
136 Appendix 23 (UKTI), annex H, and Appendix 27 (UKTI), annex R
137 Appendix 27 (UKTI), annex R
3 Barriers & Opportunities

53. As we noted above, while Brazil offers significant opportunities these do not come without potentially significant barriers. UKTI summarised the situation: “Brazil in 2007, and for the foreseeable future, will likely be a very familiar place. It will be open for business and trade, but bogged down with bureaucracy and outdated legislation that hamper the realisation of its full potential”, to which it also added the obstacle of the power of vested interests.  

Barriers

54. Brazil’s tax system and its underinvestment in infrastructure were highlighted in Chapter 1 as factors limiting Brazil’s growth potential. UKTI outlined six main barriers to trade and investment: tariffs and customs processes, services, bureaucracy and over-regulation, the tax system, employment regulations and intellectual property issues. During our visit and in oral and written evidence we have heard about these and other barriers to trade with and investment in Brazil, which for some make trade simply too arduous and costly in comparison with the potential returns. We also sought for information via UKTI from companies that we were told had looked at or tried to trade with Brazil, and subsequently decided against it.

Awareness & local knowledge

55. The British Chambers of Commerce in Brazil said that an ignorance of the opportunities in Brazil, particularly among SMEs, was the fundamental barrier to increased trade and investment with Brazil, something they contrasted with the positive image of the UK in Brazil. However, in our parallel inquiry into UKTI and the marketing of UK Plc, British Expertise (the body representing professional services) told us that the businesses they represented by and large had no great interest in Brazil as its business structure was already sophisticated, contrasting this with China and India which do need British involvement in certain areas.

56. There was almost universal acknowledgement that the complexity of the market made some form of local representation or local agent essential for success in Brazil. The University of Birmingham’s SMEs and Brazil study found that assistance in Brazil, in the form of agents, partners or local staff, and personal contacts bring “valuable informal knowledge in an unfamiliar market like Brazil which has distinct regulatory systems and business practices.” British Expertise also told us that: “Lack of real knowledge of the region means that businesses wanting to invest or sell there must make a substantial and costly effort to penetrate the region. There is often insufficient incentive to do that, as

138 Appendix 23 (UKTI), annex A
139 Appendix 6 (British Chamber of Commerce in Brazil)
140 The evidence given to our parallel inquiry is to be published as The Future of UK Manufacturing, HC 161 of Session 2006-07. The evidence from British Expertise may be found at Q 381.
141 Appendix 29 (University of Birmingham), summary and para 6
against using resources in other parts of the world that are better known. An acquisition is one way to tackle this, but you are still left with all the other problems.”142 They also said that a professional services company looking to enter the market should be well prepared, and have representatives with a good command of the language.143

Language

57. Although there are a number of Portuguese-speaking countries in Africa, Brazil is the only Portuguese-speaking country in the Western Hemisphere. The Portuguese language was cited as a difficulty by a number of witnesses, including UKTI144 and the CBI, who said that Portuguese was not one of British business’s strongest language suits.145 The University of Birmingham SMEs & Brazil study found language to be the greatest barrier in trading with Brazil.146 British Expertise noted that Portuguese and Spanish are less widely taught in the UK than other languages, that private firms cannot afford comprehensive language training, and also that language was a greater barrier to trade in services than goods. 147 British Expertise said that given that South America had two major languages there was an expectation that those wishing to do business there would speak at least one, which it contrasted with China and Russia.148 While we experienced few problems in speaking English during our visits to Brazilian companies and organisations, we were told that among Brazilian middle and senior management English skills are non-existent, although younger staff have greater skills.149 We also heard that business enquiries had met no response until they were sent in Brazilian Portuguese.150 While language is clearly a barrier, during its inquiry into trade with China the previous Committee found that UK businesses were unlikely to be successful unless they employed Chinese speakers, suggesting that the language problem is not unique to Brazil. The damaging presumption, still too widespread in the British business and political culture, that English is the universal language of trade and the only necessary linguistic tool when doing business abroad, is harming our commercial prospects in Brazil just as it is in many other markets around the world.

Import tariffs & customs procedures

58. One of the most overt barriers is the comparatively high level, by developed country standards, of import tariffs on goods. UKTI told us: “Some of the old protectionist instincts remain, as do some of the regulations that impede the import of goods and services
perceived to represent a potential threat to local interests.” As previously noted, the Mercosur customs union is imperfect, with a number of exceptions to the Common External Tariff (CET), and since tariffs vary across the bloc its members do not have the same average tariff levels. Mercosur’s CET ranges from 0% to 23%, but some goods, including electronics, are excluded from it. The CBI noted that countries had unilaterally altered their tariffs from the CET, citing Argentina’s recently increased import duties on consumer goods.

59. Brazil’s bound tariffs, the maximum tariff level consistent with its World Trade Organisation commitments, average over 31%. The simple average of Brazil’s applied tariffs—the import taxes actually charged—in 2006 was 12.3%, more than double that of the EU (5.4%), ranging from 10.2% on agricultural products to 12.6% on industrial products. As the table below shows, Brazil’s average tariffs compare favourably with those of India, which is the only genuine comparator for Brazil among the BRICs because, as a member that has acceded to the WTO since the last trade round was completed, China has taken on greater tariff commitments than either Brazil or India, while Russia is currently seeking accession to the WTO.

Figure 6: Average applied tariffs, 2005/2006 (%)

<table>
<thead>
<tr>
<th></th>
<th>Agricultural products</th>
<th>Industrial products</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil (2006)</td>
<td>10.2</td>
<td>12.6</td>
<td>12.3</td>
</tr>
<tr>
<td>Russian Federation (2005)</td>
<td>13.5</td>
<td>11.1</td>
<td>11.4</td>
</tr>
<tr>
<td>India (2005)</td>
<td>37.6</td>
<td>16.4</td>
<td>19.2</td>
</tr>
<tr>
<td>China (2006)</td>
<td>15.7</td>
<td>9.0</td>
<td>9.9</td>
</tr>
<tr>
<td>EU25 (2006)</td>
<td>15.1</td>
<td>3.9</td>
<td>5.4</td>
</tr>
</tbody>
</table>

Source: WTO database (accessed April 2007)

60. Reductions in Brazil’s industrial products tariffs in particular are a key interest for developed countries including the EU in the Doha Round negotiations at the WTO, and in any potential EU-Mercosur free trade deal (see Chapter 6). In addition to import tariffs, we were informed that imports, like other goods, face two value-added taxes which vary across

151 Appendix 23 (UKTI), para 5.1
152 Appendix 10 (CBI), para A8
153 Ibid.
154 WTO statistical database, April 2007
155 Ibid., September 2006
the country. UKTI also said that since 2004 two additional taxes have been levied on imports at a combined rate of 9.25%.

61. On customs procedures, we were told of high port costs and various inefficiencies, strikes, corruption and bureaucratic barriers: UKTI said that “Paperwork must be 100% correct or serious problems will arise.” The University of Birmingham SME study also identified problems with clearing shipments through customs and a need to reduce the number of signatures required for import and export. We saw evidence that some UK companies have been unable to clear products for exhibitions through Brazilian customs sufficiently quickly, and it can take six months to be registered on Brazil’s computerized customs systems. During our visit we heard about some instances of inappropriate facilitation payments for fast-tracking releases of imports: UKTI mentioned corruption in relation to ports (which we also heard about anecdotally during our visit), and SMEs reported that customs delays were “encouraged by opportunities for corruption.” However, the CBI did not raise such problems specifically in connection with Brazil. Though tariff and customs barriers cause annoyance to potential importers and may provide opportunities for corruption, the situation is no worse—and in some cases less serious—in Brazil than in other developing countries. It is important, though, that this issue is addressed in the JETCO process.

62. ‘Trading across borders’ was Brazil’s highest and therefore best ranking category (53rd out of 175) in the World Bank’s Doing Business report, which looked at a typical goods shipment from contractual agreement to receipt. The World Bank put Brazil above the Latin America & Caribbean region average on every indicator in this category, but although it compared reasonably well with the developed Organisation for Economic Co-operation and Development (OECD) country average on exporting, it performed somewhat worse on importing, for example taking double the average number of days for import in the OECD countries (see Fig. 7, overleaf).

63. The WTO trade facilitation negotiations which cover, among other things, these kinds of customs issues have made comparatively good progress. However, success in this area is dependent on progress in some of the more difficult areas of negotiations within the overall Doha Round, of which trade facilitation is just one element.

---

156 ISS and ICMS. See Appendix 8 (British Telecom), para 14, and also Appendix 23 (UKTI), annex E.
157 PIS and COFINS (Appendix 23, annex E)
158 Appendix 23 (UKTI), annex E
159 Appendix 29 (University of Birmingham), para 25
160 Appendix 19 (Paul Eadie MBE)
161 Appendix 29 (University of Birmingham), para 7
162 Q 119
163 See Chapter 6
Figure 7: World Bank *Doing Business* rankings: ‘Trading across borders’

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Brazil</th>
<th>Latin America &amp; Caribbean (region average)</th>
<th>OECD (average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Documents for export (number)</td>
<td>7.0</td>
<td>7.3</td>
<td>4.8</td>
</tr>
<tr>
<td>Time for export (days)</td>
<td>18.0</td>
<td>22.2</td>
<td>10.5</td>
</tr>
<tr>
<td>Cost to export (US$ per container)</td>
<td>895</td>
<td>1,068</td>
<td>811</td>
</tr>
<tr>
<td>Documents for import (number)</td>
<td>6.0</td>
<td>9.5</td>
<td>5.9</td>
</tr>
<tr>
<td>Time for import (days)</td>
<td>24.0</td>
<td>27.9</td>
<td>12.2</td>
</tr>
<tr>
<td>Cost to import (US$ per container)</td>
<td>1,145</td>
<td>1,226</td>
<td>883</td>
</tr>
</tbody>
</table>


**Services**

64. UKTI considered Brazil to be a relatively open market for financial services, though there were some restrictions in areas such as legal services and insurance.\(^{164}\) These comprised restrictions on cross-border supply of services, on the ability of UK service providers to establish a commercial presence in Brazil, and on UK service professionals seeking temporary access to Brazil.\(^{165}\) There have also been difficulties clearing WTO financial and telecommunications services agreements through the Brazilian Congress; UKTI acknowledged that this was a difficult issue for Brazil, and that it can only be expected to move very cautiously.\(^{166}\)

65. We were told about issues in legal services, where the regulator, the Brazilian Bar Association (OAB), restricts foreign practitioners. Barriers included limits on foreign firms entering into multi-jurisdictional partnerships with Brazilian qualified lawyers.\(^{167}\) The CBI called for restrictions on legal partnership to be lifted;\(^{168}\) while Clifford Chance noted the loss of important investment opportunities due to such barriers,\(^{169}\) the sector’s “crucial

\(^{164}\) Appendix 23 (UKTI), annex F

\(^{165}\) Ibid., para E8

\(^{166}\) Ibid.

\(^{167}\) Ibid., annex F2

\(^{168}\) Appendix 10 (CBI)

\(^{169}\) Appendix 9 (Clifford Chance), paras 6 and 8
significance” to the economy,\textsuperscript{170} and the inequity that Brazilians can practise in England.\textsuperscript{171} While Brazil maintains considerable limitations on trade in services we consider it unlikely that Brazil will move forward on services liberalisation issues without progress—either multilaterally through the WTO Doha Round or bilaterally through EU-Mercosur negotiations—in areas in which it has key interests, particularly agriculture.

\textit{Regulation, licensing & bureaucracy}

66. UKTI said that UK companies find regulation in Brazil “quite stifling”,\textsuperscript{172} and told us that municipal, state and federal regulation and bureaucracy added up to “a bewildering array of rules, regulations and paperwork that can quickly swamp the unwary or ill-prepared exporter or investor.”\textsuperscript{173} Complex regulation in areas such as employment law was seen as a particular barrier for SMEs.\textsuperscript{174}

67. Other areas of difficulty were restrictions on work permits, onerous certification requirements, lengthy product registration procedures, and measures to encourage local production.\textsuperscript{175} We were also told of regulatory agency backlogs which “can delay the introduction of novel goods and services for months or even years.”\textsuperscript{176} One company alleged that the Brazilian authorities lacked interest in approving their chemical products for use—not that they had turned them down, but that they had not even considered them—with the suggestion that rather than being the exception this was the norm.

68. Regulatory issues are reflected in the World Bank’s \textit{Doing Business} study, which ranked Brazil poorly on dealing with licences, closing a business, enforcing contracts, registering a property, starting a business and employing workers.\textsuperscript{177} The CBI argued that there was a need for clearer and more consistent application of regulation, and for greater transparency and timeliness in formulation and enforcement of regulations. The CBI said that it would also welcome an “exchange of best practice and a push towards more mutual recognition of standards”.\textsuperscript{178}

69. In the meantime, the CBI told us that there are “well established methods (indeed whole industries dedicated to identifying and facilitating these methods) of navigating the bureaucracy without drowning in it. These work-arounds do not generally rely on corrupt or illegal practices; instead they are established ways through the tangle of bureaucracy that the better local companies have mapped out. Knowledge of how to operate these \textit{little}
ways’ is one of the reasons that exporters must have the right local representation if they are to operate effectively in Brazil.179 UKTI said that while local partners were not a requirement, “if you have got a local partner it is a lot easier to get through the mass of regulation. […] it is imperative for British companies that want to really establish themselves in the market to have some local knowledge.”180 We note the strong positioning of UKTI to help UK businesses identify such partners.

**Labour market**

70. Possibly partly due to the regulatory issues outlined above, some 60% of the Brazilian workforce is thought to be in the informal sector,181 with the CBI suggesting that the informal sector could account for around 40% of Brazil’s GNP, compared with 23% of India’s, 13% of China’s and 46% of Russia’s.182 The informal sector has an unfair advantage over legitimate businesses, and results in tax and social security evasion, reduced government revenue and so higher taxation on the formal sector and poorer public services.183 In the formal sector employees have “strong protections” in terms of conditions and social provision, with employers paying an average 100% of an employee’s salary in social costs and taxes—an incentive for informal employment to reduce these costs. While these difficulties in theory affect all companies operating in Brazil, UKTI noted that the competitiveness of foreign companies was constrained as they were either unable to use the grey economy in this way or unwilling to do so as this would be likely to breach corporate social responsibility standards.184 Moreover, there are additional regulations that bear more heavily on foreign companies. For example, in common with other developing countries, Brazil has rules limiting the number of expatriates who may be employed in companies: for those employing three or more people, Brazilian nationals must make up a minimum of two-thirds of total employees and must receive at least two-thirds of the total payroll, although foreign specialists in areas lacking sufficient Brazilians are not included where calculating the one-third allowed for non-Brazilians.185

**Taxation system**

71. Brazil has taxes at federal, state and municipal level, including value-added taxes at both the federal and state level. Its tax system has been described as “bewildering.”186

---

179 Appendix 23 (UKTI), annex E
180 Q 51
181 ‘Left turn ahead? How flaws in Lula’s plan could condemn Brazil to lag behind its peers’, *Financial Times*, 22 February 2007, although the US State Department estimates around 40% of all workers not being formally registered (2006 Investment Climate Statement – Brazil; [http://www.state.gov/e/eb/ifd/2006/61964.htm](http://www.state.gov/e/eb/ifd/2006/61964.htm))
182 Appendix 10 (CBI), para 10
184 Appendix 23 (UKTI), annex E
185 US State Department, 2006 Investment Climate Statement – Brazil; [http://www.state.gov/e/eb/ifd/2006/61964.htm](http://www.state.gov/e/eb/ifd/2006/61964.htm) and also Appendix 10 (CBI), para 31
186 ‘Left turn ahead? How flaws in Lula’s plan could condemn Brazil to lag behind its peers’, *Financial Times*, 22 February 2007
“complex and burdensome”187 and “one of the most complex taxation systems in the world”188 with estimates of the number of taxes facing companies ranging from 62 or 65, up to 75.189 According to The Economist, Brazil has a “poorly structured revenue system marked by heavy tax burdens, a narrow taxable base, complicated levies and widespread tax evasion. Companies, both foreign and domestic, employ tax professionals and devote considerable resources to managing their tax affairs. The corporate and indirect taxation systems are particularly complex, porous and unwieldy; the income tax system is considered to be relatively efficient, with a top rate of 27.5%.” However, the US State Department says that Brazil’s taxes “do not discriminate between foreign and domestic firms, although in a few instances there have been complaints that the value-added tax collected by individual states (ICMS) is set to favour local companies.”190 The University of Birmingham’s study of SMEs and Brazil concluded that simplification of Brazil’s tax structure would be helpful.191

72. Moreover, BT pointed out that some services were subject to “cumulative taxation”, with taxes payable twice for the same service, giving the example that when a service is bought and resold both suppliers and providers pay taxes that cannot be credited like VAT, which “combined can amount to an additional 15% cost.”192 Anglo American also told us that Brazil’s transfer pricing laws were at odds with OECD guidelines, with consequent effects on corporate income tax and social contribution taxes.193

73. Reflecting these problems, the World Bank’s Doing Business study ranked Brazil lowest on ‘paying taxes’—151st out of 175, much lower than its overall rank of 119th. The basis for this is the tax paid by a typical medium-sized company and associated administrative burdens. The table shows that Brazil compares unfavourably with not only the OECD, but also the Latin America and Caribbean region on the time taken to deal with taxes, which at 2,600 hours is the longest among the 175 countries surveyed (the second longest, Ukraine, was 2,185 hours). The figure for Brazil was more than twelve times the average time taken to deal with taxes in OECD countries, and six times the average in the Latin America and Caribbean region and, as the British Chamber of Commerce in Brazil noted, compares with a world average of 332 hours.194

187 Appendix 10 (CBI), para 30
188 Appendix 23 (UKTI), annex E
189 The lower estimate was provided by the CBI (Q 106) and the higher by UKTI (Appendix 23, annex E).
191 Appendix 29 (University of Birmingham), para 25
192 Appendix 8 (British Telecom)
193 Appendix 1 (Anglo American plc)
194 Appendix 6 (British Chamber of Commerce in Brazil)
Figure 8: World Bank *Doing Business* rankings: ‘Paying taxes’

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Brazil</th>
<th>Latin America &amp; Caribbean (region average)</th>
<th>OECD (average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments (number)</td>
<td>23.0</td>
<td>41.3</td>
<td>15.3</td>
</tr>
<tr>
<td>Time (hours)</td>
<td>2,600.0</td>
<td>430.5</td>
<td>202.9</td>
</tr>
<tr>
<td>Total tax rate (% profit)</td>
<td>71.7</td>
<td>49.1</td>
<td>47.8</td>
</tr>
</tbody>
</table>

*Source: World Bank, Doing Business 2006*

74. UKTI told us that attempting to comply with this system meant large inputs of managerial time and investment in tax consultancy. Moreover, it opened the way for a range of inappropriate activities contrary to good business practice. UKTI also noted that foreign companies established in Brazil were taxed on their world-wide income (as are Brazilian firms), and that the lack of a double taxation agreement seriously damages the viability of such investments.195

75. There have been some tax reforms: a law simplifying corporate tax payments for small and medium-sized companies—SIMPLES for small business196 and Presumed Income for medium-sized businesses—for example, and there is talk of amalgamating Brazil’s indirect taxes into one national value-added tax, a move which would require the support of Brazil’s state governors.197 However, the US State Department states that Brazil failed to pass measures to simplify and harmonize state-level VAT in 2003.198

### Intellectual Property Rights

76. The International Chamber of Commerce’s Business Action to Stop Counterfeiting and Piracy survey of multinationals found Brazil to be the fourth worst country on protecting Intellectual Property Rights (IPR) after China, Russia and India.199 We heard that piracy of copyrighted material was a serious problem:200 a perception shared by the US Government201 and the European Commission, which has listed Brazil alongside other

---

195 Appendix 23 (UKTI), annex E; this issue is further explored in paragraphs 92-95.
196 The British Chamber of Commerce in Brazil noted that the Simples system allows “single monthly tax payment for companies with revenue under $1.1 million a year, covering 8 taxes, 12 labour taxes and one municipal tax (90% business approval)”. (Appendix 6)
197 “Left turn ahead? How flaws in Lula’s plan could condemn Brazil to lag behind its peers’, *Financial Times*, 22 February 2007
198 US State Department, 2006 Investment Climate Statement – Brazil: [http://www.state.gov/e/eb/ifd/2006/61964.htm](http://www.state.gov/e/eb/ifd/2006/61964.htm)
200 Appendix 10 (CBI), para 39
Mercosur countries (Argentina and Paraguay) as a country where future trade relations would need a greater focus on IPR enforcement.202

77. Both the CBI and the Trade Minister noted the importance to companies of being able to enforce their intellectual property rights.203 UKTI said that, in principle, Brazil had a sound IPR and patent system, but noted that its effectiveness and impartiality in enforcement was variable, and that legal processes were protracted and expensive.204 The Trade Minister pointed out that IPR problems were common among emerging economies, and therefore not only a problem for Brazil, and that this was “a fundamental issue which always arises in building up business confidence and being prepared to do business.”205

78. The Brazilian Embassy told us that Brazil was doing more than ever to combat piracy.206 In November 2004, an inter-ministerial National Council to Combat Piracy and Intellectual Property Crimes (CNCP) was created. A National Plan for Combating Piracy was adopted in 2005. The Embassy also noted that Brazil implemented its WTO Trade-related aspects of Intellectual Property Rights (TRIPS) agreement obligations ahead of the final deadline for developing countries, with ‘TRIPS-plus’ provisions in some areas. The US’s recent annual review of IPR enforcement in other countries recognised progress on IPR, the action plan, stating that the National Anti-Piracy Council “is increasingly recognized as a model of public-private collaboration in the area of IP enforcement.”207 This saw Brazil demoted from the highest level ‘priority watch list’ to the lower level ‘watch list’, although an ‘out-of-cycle’ review of progress will take place, with similar reviews covering Russia, the Czech Republic and Pakistan, and with China subject to a year-long review. Both Argentina and Venezuela among Mercosur countries remain on the priority watch list, as do all three other BRIC countries (China, India and Russia).208

79. The UK-Brazil Joint Economic and Trade Committee (JETCO) included IPR in its recommendations for action.209

Other issues

80. We were also informed of problems in relation to obtaining business visas, opening offices in Brazil, employing local staff, opening bank accounts, and repatriating funds.210 We saw no specific evidence of corruption, although it was raised obliquely in reference to


203 Q 115 and 182

204 Appendix 23 (UKTI), annex E

205 Q 183

206 Appendix 4 (Brazilian Embassy)


208 US Trade Representative, 2007 Special 301 Report, pp 1-2, 25 and 28

209 See paragraph 88 below.

210 Appendix 29 (University of Birmingham), para 25
facilitating clearance of imports, and the US State Department states that while “Federal government authorities generally investigate allegations of corruption, there are inconsistencies in the level of enforcement among individual states.” Brazil is a signatory to the OECD Anti-Bribery Convention and the UN Convention against Corruption. Transparency International ranked Brazil 62nd out of 159 countries on the perception of corruption in 2005, where 1st is the least corrupt (the UK was ranked 11th). By comparison with the other Mercosur countries, Uruguay ranked above Brazil at 32nd, while the other Mercosur countries ranked below it: Argentina at 97th, Venezuela at 130th and Paraguay at 144th.

81. We also considered whether the fact that Brazil does not currently enjoy investment grade status—that is, it is not regarded as a lower risk, high quality investment—or at least the factors behind this, could partly explain the relative lack of UK investment. India was recently returned to investment grade by Standard & Poor’s after 15 years of ‘junk’ status. The CBI said that generically investment grade status was an “important factor” among a range of others for corporate risk, but other than noting that “Brazil is looking forward to obtaining investment grade status from international rating agencies” it did not highlight this as a specific problem for Brazil. In any case, there are indications that Brazil’s status may be upgraded, perhaps within the next two years if its public finances remain stable.

82. We recognise that a number of real, if surmountable, barriers exist to trade with and investment in Brazil, but given that these generally face our competitors as well, we find these insufficient to explain the relatively poor performance of the UK. Other than the problems we have outlined, witnesses did not pinpoint any other factors that would explain this situation. We are therefore led to conclude that awareness and perception issues are the greatest barriers to trading with Brazil. We hope that this Report will help to make British business more aware of the opportunities afforded by, and give indications of how companies can tackle some of the difficulties involved in doing business with, Brazil.

The Joint Economic and Trade Committee (JETCO): Tackling barriers bilaterally

83. The UK and Brazil agreed to establish a Joint Economic and Trade Committee (JETCO) during President Lula da Silva’s state visit to the UK in March 2006. As the Trade Minister noted, similar committees have already been established with China and India (as

211 US State Department, 2006 Investment Climate Statement – Brazil: http://www.state.gov/e/eb/ifd/2006/61964.htm
212 Transparency International, Global Corruption Report 2006, table 11.1
213 The Financial Times notes that this is despite India’s public finances being much weaker than other comparable countries: 85% debt to GDP, over 3 times that of China (‘India returns to full investment grade after status 15 years’, Financial Times, 31 January 2007, p6)
214 Appendix 10 (CBI), para 9
215 Q 109
well as an Intergovernmental Steering Committee in the case of Russia). The Trade
Minister said that JETCOs were “a way forward” in the case of Brazil, China and India
where there are “massive opportunities but also clearly areas where they cannot be realised
because of significant impairments to trade”. Its aims are to improve economic relations,
“systematically examine why UK companies appear to under perform in terms of trade and
investment with Brazil”, and to agree joint strategies to tackle bilateral trade and
investment impediments.

84. The UK Government intends JETCO to give businesses a “platform” to share their
concerns with ministers in the UK and Brazilian governments. The success of the JETCO
is likely to depend crucially on the amount of business interest in developing UK-Brazil
relations, raising issues and providing solutions to problems. The JETCO with India has
been backed by business organisations like the Indo-British Partnership Network, a body
created by UK businesses to encourage bilateral trade between the two countries. In the
case of Brazil, JETCO has the support and involvement of the CBI, the British Chamber of
Commerce in Brazil, its Brazilian equivalent (the CNI) and FIESP, the business body for
São Paulo state. The CBI was closely involved in the business side of the inaugural
meeting and pushed for an “action-oriented agenda”, with the recommendations being
“broadly similar to the sorts of concerns that Brazilian business itself has about the changes
and reforms that it wants to see in Brazil.”

85. There will be annual ministerial-level JETCO meetings alternating between the two
countries, interspersed with at least one meeting of officials. The first ministerial-level
meeting took place in Brasilia in September 2006. Fifteen recommendations were made,
including a general call for increased UKTI resources in Brazil and the UK and
awareness-building events, as well as highlighting the importance of reaching bilateral
investment and taxation agreements, tackling intellectual property rights issues,
co-operating in three ‘strategic sectors’ (aerospace, financial services and healthcare) and in
science. Key recommendations and progress are explored in more detail below. Science
aspects are considered in Chapter 5.

86. The first six-monthly meeting of officials took place in São Paulo on 13 March 2007,
with around six officials from each country plus business representatives. UKTI said that
while “there were many ideas, there was little consensus from business”, and the focus was

---

217 Reportedly the UK Government is looking to “revive” this (British cabinet minister makes case for greater UK-
Russian trade’, British Embassy in Russia press release, 6 February 2007:
http://www.britishembassy.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=108912
3753173&a=KArticle&aid=1170252068627)
218 Q 189
219 Appendix 23 (UKTI), para 6.29
220 ‘Darling paves way for stronger trade relations with Brazil’, UKTI press release, 7 September 2006
221 See www.ibpn.co.uk.
222 Appendix 27 (UKTI), annexes C and G (point 12)
223 Q 110
224 Q 106
225 Other recommendations include ratifying the Brazil-UK Agreement on the Taxation of Air Transport and Shipping
(priority x), and joint ventures between UK and Brazilian professional services firms (priority xiv).
on possible sectoral and/or issue working groups, and a planned seminar on ‘Doing Business in Brazil’. UKTI explained that the elections and government changes in Brazil had limited progress in some areas: for example the Brazilian Trade and Industry Minister was only appointed on 23 March 2007. Perhaps the most progress has been made on the Doing Business in Brazil seminar, which was originally scheduled for 16 May 2007 but will now take place on 25 June 2007 at the DTI Conference Centre in London. A UK visit by the Brazilian Ministry of Trade was planned, focusing on technical aspects of the services sector. Also planned are joint events on professional services alongside the Lord Mayor’s Brazil visit in August, and a possible mission to the UK at the same time as the London JETCO Ministerial meeting in September 2007. However, it seems that there has been less progress in other areas, notably on the bilateral investment and taxation agreements.

87. We support the creation and work of the UK-Brazil JETCO, but note that its success will depend on maintaining both political and business interest and involvement in both countries. We are pleased to see that events are being planned which will serve to raise awareness of the available opportunities, but while we recognise it is still early in the life of the JETCO with Brazil, progress over the six months since the Ministerial meeting has been limited. Certainly the planning work so far needs to be converted into genuine action: we believe that it is essential that momentum is maintained to ensure the continued support of business and to maximise JETCO’s awareness-raising potential.

**IPR & the JETCO**

88. The CBI told us that IPR was “an incredibly important” issue for British businesses, and it highlighted IPR as one of the three most important JETCO recommendations. The two sides “agreed to examine IPR issues under government leadership, with a view to increasing co-operation, including promoting innovation and transfer of technology initiatives, in order to reach the adequate level of protection of intellectual property rights in both countries.” The Trade Minister said that he believed the Brazilians “are seized with the need to work” on the IPR area. A two-week training programme in Brazil on IPR provided by the UK Patent Office has also been proposed.

89. As we have noted earlier, Brazil’s failures in intellectual property rights protection lie in the area of enforcement, not legislation. The UK has a good record in enforcement and could provide useful training and advice. Without advances in

---

226 Appendix 27 (UKTI), annex C
227 Ibid; We were also told that the ratification of the UK-Brazil Air Services Agreement had been delayed because of the Brazilian elections.
228 See paragraphs 89-95
229 Q 114
230 JETCO priority xi
231 Q 183 (Trade Minister)
232 Appendix 27 (UKTI), annex A (point 11)
enforcement, Brazil may well not receive the investment it needs to develop high-tech and science R&D, from either the UK or elsewhere.

**An Investment Protection & Promotion Agreement (IPPA)**

90. Although an Investment Protection & Promotion Agreement (IPPA)—a bilateral investment treaty that provides for equal treatment for investors, compensation in the event of expropriation, and independent settlement of any disputes—was signed with Brazil in 1994, it has yet to be approved by the Brazilian Congress. In fact Brazil has no such agreement with any country, and similar agreements with other countries were withdrawn from consideration by the Brazilian Congress in 2003. The CBI saw an IPPA with Brazil as one of its top priorities, UKTI emphasized the issue, and the Trade Minister concurred. The CBI told us that ratification “would mark a major step forward in the framework for investment relations between the two countries.” They said it was “important in terms of providing confidence and stability and a sort of comfort that if they invest certain things will happen if things go wrong.” The JETCO recommendation highlighted “the importance to business of the adoption of a comprehensive” IPPA.

91. However, progress in these areas appears to have been minimal and the portents are not good. UKTI suggested that the IPPA’s presence among the JETCO recommendations represented a step forward, although the officials were unable to promise that Brazil would “change its attitude overnight”. The Trade Minister said that the British Government were attempting to expedite the IPPA issue, but that this was “a difficult area for us to resolve”. He said that while the Brazilian Government had suggested a mechanism for attracting investors, this fell “far short of” what the UK Government sees as an IPPA. However, a working group had been set up in Brazil to examine all of its IPPAs.

92. However, it appears that there are difficult, possibly insurmountable, constitutional obstacles to ratification by Brazil. When we pressed the Trade Minister on the prospects of significant progress in the immediate future, he said: “No. To give you any other impression would be misleading in the extreme.”

---

233 Appendix 27 (UKTI), annex L
234 Qq 114 (CBI), 36 (UKTI) and 183 (Trade Minister)
235 Appendix 10 (CBI), para 35
236 Q 109
237 JETCO statement, priority xiii
238 Q 36
239 Q 183
240 Ibid.
241 Appendix 27 (UKTI), annex L
242 Q126 (CBI). The US State Department notes the “legal controversy in Brazil over binding foreign arbitration between foreign investors and state entities. Some Brazilian legal interpretations claim this is prohibited under Brazilian law on the grounds that it infringes the sovereign rights of the state [...] legal uncertainty, as well as congressional politics, has held up ratification of Bilateral Investment Agreements that Brazil has signed” (US State Department 2006 Investment Climate Statement – Brazil: [http://www.state.gov/e/eeb/ifd/2006/61964.htm](http://www.state.gov/e/eeb/ifd/2006/61964.htm) which also states that “The US and Brazil currently have no plans to discuss a BIT”)
243 Q 188
political issues that lie behind the non-ratification of Brazil’s bilateral investment agreements’ an IPPA between the UK and Brazil is unlikely in the near future. It was perhaps over-ambitious to include such a difficult issue in the JETCO priorities, but it nevertheless remains an important goal for UK business, and we urge the Government to do all it can to ensure that progress is made.

**A double taxation agreement**

93. Double taxation agreements ensure that income received or gains made in one country by residents of another country are taxed only once. Brazil has double taxation agreements with a number of countries including Argentina, Canada, Chile, China, France, Germany, Italy, Japan, Luxembourg, the Netherlands, and Spain, but neither the UK nor the US. A double taxation agreement with Brazil was one of the CBI’s top priorities. The issue was also raised by both Anglo American and in the University of Birmingham SMEs and Brazil study, which concluded that it would be “an important step forward.” The JETCO recommendations reflect this.

94. Brazil is reluctant to conclude a double taxation agreement. The UK insists that such agreements must be based on the OECD Model Convention, which offers a template for bilateral tax agreements, and this appears to have hindered progress on this issue. As the Trade Minister explained, “Our double taxation policy is close to the OECD model treaty and we should like that to be the starting point for our discussions with Brazil. […] Brazil’s policy varies significantly from the OECD model and Brazil is unwilling to give up its taxing rights […] but we think that the best way forward is the OECD model.” He said he believed the CBI agreed with the Government’s stance, and went on to say that Brazil’s double taxation arrangements with other countries “have limited benefits and I do not think they fully cover the OECD model. The problem is that they have settled for second best, but we are not yet prepared to do that.”

95. UKTI has subsequently suggested that it was “not true to say that any treaty would be better than none”, and that this “would prejudice the terms of other treaties that are being negotiated within the region e.g. with Chile.” Officials noted that OECD members that did have agreements with Brazil have frequently reported problems in their application, and in 2005 Germany had decided to terminate its agreement unilaterally after “differences of interpretation.” UKTI told us of plans for a senior HM Revenue and Customs policy

---

244 Q 186 (DTI); Appendix 27 (UKTI), annex L; US State Department, 2006 Investment Climate Statement – Brazil: [http://www.state.gov/e/eeb/ifd/2006/61964.htm](http://www.state.gov/e/eeb/ifd/2006/61964.htm)
245 Q 114 and 125 and Appendix 10 (CBI), para 30
246 Appendix 1 (Anglo American plc)
247 Appendix 29 (University of Birmingham), para 25
248 JETCO statement, priority xiii
249 Q 186
250 Appendix 27 (UKTI), annex L
adviser to visit Brazil in Spring 2007 “to take forward technical level exchanges on the Double Taxation Agreement”.251

96. In the case of a prospective double taxation agreement it seems there is a certain amount of intransigence on both sides. While UKTI said that an agreement was unlikely, it remains possible that the UK’s investment statistics with Brazil are being distorted by the double taxation agreements between Brazil and other EU countries in particular: during our visit we were told of one case where a company routed business via Italy to take advantage of its tax agreement with Brazil. We therefore urge the Government to re-examine this matter which seems likely to be putting us at a disadvantage vis à vis our competitors, and remains a key priority of UK businesses. If the re-examination demonstrates the significance we anticipate, then such a treaty must become a key objective of the JETCO process.

Opportunities by sector

97. While it may not be easy to trade with Brazil our evidence suggests that there are a number of sectors in the Brazilian market with opportunities for UK businesses. UK companies are currently involved only in a limited way in some sectors, which may have the effect of discouraging risk-taking by other, particularly smaller, companies. To some extent this limited involvement reflects the fact that in some important sectors, such as mobile telecommunications252 and water services, decisions on global strategy are no longer taken from a purely UK perspective due to ownership structures that mean that many such companies are UK subsidiaries of companies based in other countries.

98. In our terms of reference we highlighted aerospace, financial services, information technology, life sciences, and oil and gas as offering particularly good opportunities for UK companies. UKTI provided us with useful detailed briefings on each of these, as well as on its other priority sectors, environmental technology and healthcare. The evidence accompanying this Report contains the full sector briefings,253 and key elements are summarised below, first for the three JETCO strategic sectors, and then for the remaining sectors (life sciences is covered in Chapter 5).

99. There appears to be a discrepancy between UKTI’s sectoral priority markets for Brazil and the three sectors identified by the JETCO as ‘strategic’. Two of the JETCOs ‘strategic sectors’, aerospace and financial services, are seen by UKTI as merely ‘opportunity sectors’ in Brazil, with only healthcare being a priority sector. We are not clear how these two sectors were singled out as strategic by JETCO, yet merely opportunity sectors by UKTI. It is imperative that there is consistency between the priorities of JETCO and UKTI.

251 Appendix 27 (UKTI) annex A (point 13) and annex B

252 The market is dominated by Portuguese, Spanish and Italian operators. UK companies are not involved in the market, but while Vodafone has pursued Hutchinson-Essar of India it only operates in Brazil in a partnership with America Movil Group. British Telecom has a “growing presence” in the region, with Brazil as its key market and one of its six global network centres based there. See Appendix 8 (British Telecom).

253 Appendix 23 (UKTI), annex F, passim
Aerospace

100. After a seminar attended by 50 UK companies saw just four companies following up leads, the UKTI Aerospace Sector Advisory Group demoted Brazil from priority status to a second tier in November 2005. UKTI told us that Brazil’s aircraft manufacturer Embraer is “key to the Brazilian market for UK companies”; hardly surprising if the claim made by the company during our visit, which we have no reason to doubt, that they have overtaken Bombardier and are now the third largest civil aircraft manufacturer in the world is substantiated. However, UK content in its aircraft is less than 2% and “current relationships with existing partners make it very difficult to displace the existing supply chain for existing programmes. New programmes will demand a higher level of local content”. These local content rules were seen as the main reason for low interest among UK firms. However, we were also told during our visit to Embraer about their entrepreneurial approach to risk-sharing with their suppliers and the resultant nature of their contractual arrangements with those suppliers. Such arrangements certainly add to the challenge of doing business with the firm.

101. Following the inclusion of aerospace as a strategic sector within the JETCO recommendations, UKTI’s aerospace sector group commissioned a report to reassess the sector. This found that, despite the presence of Rolls-Royce and three UK SMEs, the market was still dominated by Embraer and its well-established supply chain that “costs more to break into” compared with getting involved in new chains in India, for example. The report also noted that Embraer preferred its trading partners to make inward investment as opposed to dealing with companies interested in supplying products or services. The report identified the kinds of barriers we have discussed above, including tax and local representation (a particular barrier for new entrants), and the advantage for European competitors of having an established presence, as well as a lack of incentives such as the tax breaks offered by, for example, the US and Mexico. All of this undermines companies’ efforts to the point that they have “moved on to try other, easier markets.”

102. The aerospace industry called for “focus on addressing barriers and highlighting the difficulties of getting into Embraer’s supply chain,” and for a bilateral JETCO Aerospace Working Group to tackle the barriers and promote “trade, interchange and cooperation.” UKTI told us that this group, including the UK and Brazilian public and private sectors, was being set up and was expected to meet during 2007.

103. We note the unfortunate limitations for UK businesses caused by the Brazilian Government’s local content rules for present and future Embraer models, and that the UK remains disadvantaged against competitors with an established local presence. We
welcome the selection of Aerospace as a JETCO strategic sector, and hope that the proposed JETCO working group on aerospace will be successful in reducing the barriers.

Financial services

104. We were told by UKTI that while the UK already has a strong presence in financial services, there is increasing demand for “specialised service providers” that could present further opportunities for UK companies.\(^{260}\) There is interest in public-private partnerships (PPPs, also noted by the CBI), legal services, reinsurance and carbon trading.\(^{261}\)

105. As the Remembrancer of the City of London explained, “much of the Latin American financial world overlooks the City of London and turns instead to New York for expertise”.\(^{262}\) The Lord Mayor made a three-day visit to Brazil—Rio, São Paulo and Brasilia—as part of a broader visit to Latin America in September 2005, which focused on carbon trading and PPPs.\(^{263}\) We were pleased to hear that the Lord Mayor and the City of London will be making a longer return visit to Brazil from 23 August—1 September 2007. However, we note that while the Lord Mayor envisages visits to China, India and the Gulf every year, visits to ‘emerging markets’, including in South America, are planned only every 2–3 years.\(^{264}\)

106. On his 2005 visit to São Paulo the Lord Mayor promoted the benefits to Brazilian companies of listing in London rather than in New York and said that he would advise the London Stock Exchange (LSE) of the opportunities to attract Brazilian listings, which to date have predominantly been on the New York Stock Exchange (NYSE).\(^{265}\) During our visit to Brazil we were struck by the perception that, unlike the NYSE, the LSE was not actively engaged in Brazil. There was a feeling that the LSE’s presence was ceremonial, rather than the businesslike approach of the NYSE in Brazil. During his visit the Lord Mayor noted a “strong appetite” for a visit by the LSE to São Paulo.\(^{266}\) UKTI told us that promoting the LSE and the AIM in particular “could encourage local businesses to view London as a viable alternative to New York”.\(^{267}\) The CBI also called for more work on promoting London to Brazil.\(^{268}\) The LSE told us that it saw increasing opportunities in and enquiries from Brazil, partly due to the attraction of its being based in Europe and general dissatisfaction with US regulatory approaches, but that this was offset by the strength of cultural links with the US and the compatibility of time-zones.\(^{269}\) However, this latter point

\(^{260}\) Appendix 22 (UKTI), annex F

\(^{261}\) The Brazil Reinsurance Institute (IRB) was a state monopoly until new legislation in January 2007, and now new opportunities are available to UK companies. See, Appendix 27 (UKTI), annex D.

\(^{262}\) Appendix 1 (Anglo American plc)

\(^{263}\) Appendix 12 (Corporation of London), para 31

\(^{264}\) Appendix 13 (Corporation of London)

\(^{265}\) Appendix 12 (Corporation of London), para 31

\(^{266}\) Appendix 1 (Anglo American plc), para 31

\(^{267}\) Appendix 23 (UKTI), annex F

\(^{268}\) Appendix 10 (CBI), para 22

\(^{269}\) Appendix 16 (London Stock Exchange)
is unconvincing, given that São Paulo’s time zone is between the time zones of London and New York. We welcome the comments from the LSE, after visiting the region, that it recognised the “general lack of awareness regarding the London offering” and had now “begun to actively market to attract issuers”.\(^\text{270}\) UKTI later told us that the LSE’s International Business Development team had experienced an increase in enquiries from investment banks, law firms and Brazilian corporations regarding listing on the Alternative Investment Market (AIM).\(^\text{271}\)

107. The Trade Minister acknowledged that the UK’s financial services and banking sectors had been performing poorly in South America in comparison with competitor countries due to “20 years of under-resourcing.”\(^\text{272}\) UKTI accepts that its new financial services strategy focuses on China, India, Russia and the Gulf rather than Brazil. However, the Trade Minister told us that Brazil was a priority,\(^\text{273}\) while UKTI said that the sector team was looking at markets other than those in the strategy in the long term.\(^\text{274}\) The UKTI Financial Services Sector Advisory Board (FSSAB), the driving force for that services strategy, recently considered a paper on South America.\(^\text{275}\) UKTI told us that the FSSAB had agreed that the UK had fallen behind and saw this as a good time to “re-engage the continent”, with Brazil serving as a pilot for the region.\(^\text{276}\)

108. UKTI’s Financial Services team has provisionally allocated one of the largest budget allocations for its ‘opportunity markets’ to Brazil.\(^\text{277}\) This is expected to fund activities associated with the Lord Mayor’s visit as well as potential support for the LSE’s follow up to their 2006 visit.\(^\text{278}\) JETCO is also encouraging links between the UK’s Financial Services Authority and its equivalent in Brazil. Recent initiatives include work on public private partnerships (with Brazilian officials the largest group attending ‘master classes’ provided by Partnerships UK over the last three years) and carbon credits (with the Climate Change Projects Office visiting Brazil last year and planning to visit again this year).

109. While we welcome the setting up by UKTI of the Financial Services Sector Advisory Board (FSSAB) because of the importance of financial services to the UK economy, we note that the UKTI financial sector strategy mentions Brazil only in passing, and that country strategies are planned for China, India, Russia and the Gulf, but not Brazil. We believe the scale of opportunities for financial services available in Brazil should be recognised by placing the market on a par with China, India and the

---

\(^\text{270}\) Ibid.

\(^\text{271}\) Appendix 27 (UKTI), annex D, also notes that Infinity Bio Energy is in the process of becoming the first AIM-listed Brazilian company.

\(^\text{272}\) Q 192

\(^\text{273}\) Q 194

\(^\text{274}\) Appendix 27 (UKTI), annex D. UKTI also noted that while Brazil was in its financial services strategy, “it is perhaps the weakest of the candidates in the group” because growth was “strongly dependent on the political willpower to maintain a framework within which business can flourish.” (Appendix 23, para 6.11)

\(^\text{275}\) Appendix 27 (UKTI), annex N

\(^\text{276}\) Ibid., annex D

\(^\text{277}\) Ibid., annex N

\(^\text{278}\) Ibid. and Q 192. UKTI said it would not cover PPP, which the sector has told it should be self-funding, or insurance, which it felt should be coordinated by the private sector.
Gulf, or at least above other emerging markets. We therefore hope that the designation of financial services as a JETCO strategic sector will help redress the balance. As UKTI is developing dedicated China and India financial strategies, with Russia to follow this year, a dedicated strategy for Brazil should be seriously considered.

110. We also hope that these developments and the Lord Mayor’s planned visit to Brazil later this year will help encourage the London Stock Exchange to establish a permanent presence in Brazil, as ThinkLondon, London’s inward investment agency have in partnership with UKTI. This would have the potential to serve as a base for the whole of South America and increase competition with the New York Stock Exchange. ThinkLondon also recently reached the first bilateral investment promotion agreement between a Chinese and a European city,279 and we believe there is scope for a similar initiative with São Paulo, for example.

Healthcare

111. UKTI told us that Brazil’s healthcare market was the largest in Latin America with more than 7,000 hospitals, 280,000 doctors and annual expenditure of US$20 billion, and that it was also the largest market for medical devices in Latin America, with imports valued at over US$980 million in a market valued at almost US$2.8 billion. UKTI also identified opportunities for joint ventures with a local industry of over 500 companies, and noted that modernisation of the communications network is “encouraging IT projects in Healthcare, varying from software development to telemedicine and e-health training/services.”280

112. The UK and Brazil have a Memorandum of Understanding for the healthcare sector, signed during President Lula’s March 2006 State Visit to the UK, with the main aim of increasing co-operation in the area of blood plasma products.281 UKTI told us that a full programme of events for the sector had been approved for 2007/08, and that it was looking into how barriers such as new rules for registration of medical devices and diagnostic products could be tackled via the JETCO.

Environmental technology

113. Brazil has taken a lead among developing countries in expressing concerns about climate change and initiating activity. The potential for selling the UK’s environmental technology to Brazil is therefore good. However, UKTI considered that due to the sophistication of the Brazilian market “overseas companies must offer something new to the market. Opportunities exist for UK companies offering innovative technologies, services, and equipment.”282 The regulatory environment and lack of investment in the

279 ‘Deal boosts London as investment hub’, Financial Times, 7 March 2007, p4
280 Appendix 23 (UKTI), para 6.20 and annex F
281 Appendix 24 (UKTI), annex A
282 Appendix 23 (UKTI), para 6.17
sanitation sector resulted in UK companies leaving the Brazilian market in recent years. But some smaller companies have been successful in supplying Brazil.283

**ICT**

114. Brazil’s IT, telecoms and electronic industries had revenue of US$23 billion in 2005, with manufacturing accounting for 25% of this, including PCs, printers, telephones and other hardware, mostly in the São Paulo and Manaus free trade zones.284 There have been trade missions in both directions,285 and the National Grid, BT and LogicaCMG are all present in the Brazilian market.

**Oil and gas**

115. UKTI officials told us that if asked to rank its priority sectors the “one that specifically stands out is oil and gas”.286 UKTI’s International Oil & Gas Business Advisory Board has designated Brazil a “priority A Market”, as part of a Latin American “golden triangle” of deep water Exploration and Production, and “a significant area of the UK’s industry capability.”287 UKTI also noted that Petrobras, the former state monopoly, was planning to invest heavily up to 2011 “creating important opportunities for providers of services and supplies”,288 and that new offshore gas fields were a top priority for the Brazilian government to increase domestic production and reduce dependency on Bolivia. A new gas regulatory framework is also planned.289

116. As with healthcare, there is a bilateral Memorandum of Understanding, signed in February 2006, for the energy sector.290 UKTI told us that, subject to resources available from UKTI’s oil and gas sector team and in Brazil, a similar, or enhanced, programme of activity is envisaged for 2007.291 We welcome the fact that UKTI has made Brazil a global priority market for the oil and gas sector in recognition of the opportunities that exist in the market.

---

283 Appendix 24 (UKTI), annex A  
284 Appendix 27 (UKTI), annex J  
285 Appendix 23 (UKTI), annex F  
286 Q 43  
287 Appendix 23 (UKTI), para 6.16  
288 *Ibid.*, annex F  
289 *Ibid.*, para F5.3  
290 ‘Consultative Mechanism for Co-Operation in the Field of Energy’, Appendix 27 (UKTI), annex E  
291 Appendix 23 (UKTI), annex F: a summary of UKTI sectoral activity in 2006 is in Appendix 27 (UKTI), annex J, pp43-48
4 Science co-operation

117. Brazil’s scientific achievements and potential are not widely reported in the UK. A common view is that expressed by Lloyd and Turkeltaub who contrasted the eagerness of China and India to compete with the West for ‘intellectual capital’ by looking to build “top-notch universities, investing in high, value-added and technologically intensive industries and utilising successful diasporas to generate entrepreneurial activity in the mother country” with Brazil’s apparent reluctance to invest its windfall gains from high commodity prices in long-term economic development, including the investment necessary to attract leading professionals.292

118. We were therefore intrigued to hear that 2007 had been designated the Year of UK-Brazil Partnership in Science (hereafter referred to as the Year). Our interest led us—unusually for our trade inquiries—to invite the Government’s Chief Scientific Adviser (CSA) and head of the Office of Science & Innovation, Professor Sir David King, to give evidence.

119. As the Foreign Office state, “Science collaboration is a major way of enhancing our overall bilateral relationship with emerging economies and in turn can be used to promote influence, for example, on the regulatory framework, by actively promoting UK approaches and/or other internationally recognised benchmarks.”293 Regarding our competitors, the CSA said that the UK accounted for 12.8% of the internationally co-authored collaborative papers with Brazil, after France with 13.8% and the US with 39%.294 UKTI told us that:

“France and Germany have very active collaboration programmes involving considerable bilateral investment and joint working with the Brazilian science base. This includes joint projects and considerable exchange of academics in both directions. Japan is also active […] but not quite at the same level as France and Germany.

“Spain and Italy are active along similar lines to France and Germany but at a significantly lower level of investment. Collaboration with the US is mainly through academics working on joint projects rather than through a structured programme of collaboration between the science communities.”295

120. UKTI considered that Brazil still has substantial potential for improvement in this area, and that despite its “world class universities, many of which are private, spending on

---

292 Lloyd, J. & Turkeltaub, A., ‘India and China are the only real BRICs in the wall’, Financial Times, 4 December 2006
294 Q 258
295 Appendix 24 (UKTI), annex H
quality primary and secondary schooling is insufficient to affect a broad swathe of the population. This despite a fairly favourable 4.3% of GDP spent on public education.”

**Government science strategy & Brazil**

**The Global Science & Innovation Forum (GSIF)**

121. The CSA chairs the Global Science & Innovation Forum (GSIF) which was set up in 2005 as a “vehicle for cross-government exchanges of information and ideas to improve co-ordination of the UK effort in international science and innovation collaboration”. Its main objective is to ensure the UK is “the partner of choice for global business looking to locate Research and Development (R&D) activities overseas, and for foreign universities seeking overseas collaboration.” The GSIF is made up of officials from the OSI, DTI and UKTI, as well as the Foreign and Commonwealth Office, the Department for Environment, Food and Rural Affairs, the Department for International Development, the British Council, the Royal Society, Research Councils UK, the Department for Education and Skills, HM Treasury and the Department of Health. The Government’s March 2006 report *Science & Innovation Investment Framework 2004–2014: Next Steps* featured two policies: a £9 million programme, to be delivered through UKTI, to attract business R&D to the UK and promote innovative UK firms abroad; and the promotion of international science and innovation links with universities and high-tech clusters, particularly in China and India. The CSA said that while he was aware of the £9 million UKTI programme, he was involved only minimally in it.

122. In October 2006 the GSIF strategy identified priority countries using four ‘axes’: research, innovation, influence and development. China and India featured in three of the axes, and the fourth—the development axis—focused on Africa. Brazil featured in just one: ‘influence’. The CSA told us this axis featured countries “where it is in the strategic interests of Britain to develop closer interests”. Brazil’s history of innovation and scientific base were not yet strong enough, he suggested, to place it among the first two categories, but its position as a ‘BRIC’ and what he referred to as “the whole climate change/energy/biodiversity agenda” meant that Brazil would play an important role in the future.

---

296 Appendix 23 (UKTI), annex A
299 [http://www.hm-treasury.gov.uk/budget/budget_06/assoc_docs/bud_bud06_adscience.cfm](http://www.hm-treasury.gov.uk/budget/budget_06/assoc_docs/bud_bud06_adscience.cfm), para 1.7
300 Q 282
302 Q 285
303 Qq 249 and 258
Joint Commissions

123. The UK has established Joint Commissions on Collaboration on Science, Technology and Innovation—matched-funding networking schemes with bilateral Ministerial-level meetings held every two years to increase science and innovation collaboration—with China, India, Japan, Russia and South Korea.304 There is also a UK-India Education and Research Initiative that aims to encourage scientific collaboration, with funding of £12 million. While there is not currently a Joint Commission with Brazil, UKTI told us that the UK has committed £50,000 towards networking with Brazil to be managed by the Royal Society, but it was “awaiting confirmation of matched funding from the Brazilian side.”305 The CSA spoke of the possibility of adding a Joint Commission with Brazil although “no decision has been made at this point.”306

Life sciences & UKTI sector strategy

124. UKTI explained that the high quality of research into biotechnology, biodiversity, pharmaceuticals and vaccines in Brazil had encouraged increasing involvement of multinationals.307 It also noted Brazil’s active science parks, and believed that the best opportunities for partnerships with UK companies were in the fields of vaccines and genetics, with great interest in “collaborations for clinical trials and new drug discovery for high quality products, based on biodiversity”.308

125. Life sciences is one of five sectors where UKTI plans to devise sector strategies. The CSA subsequently informed us that the strategy will include the biotechnology, pharmaceuticals and healthcare industries, and that a wide consultation is currently underway involving the OSI among others, with a launch planned for September 2007.309

Science & Innovation Network

126. The Science & Innovation Network was set up by the FCO in 2000 to bring together science and diplomacy, which “adds value by being a network of in-country experts familiar with both the UK customer base and host country networks”. It is co-ordinated by the FCO Science and Innovation Group in collaboration with OSI and the Chief Scientific Adviser, and works with bodies like the British Council and UKTI. The network is now around a hundred strong,310 covering 35 embassies and consulates in 22 countries including São Paulo in Brazil.311 Many of the officials involved are locally employed “so they really understand the local system”, with “a very good capability of supporting visitors

305 Appendix 23 (UKTI), para 7.4
306 Q 255
307 Appendix 23 (UKTI), annex F
308 Ibid., para F4.13 & 4.14
309 Appendix 17 (Office of Science and Innovation)
310 Q 284
311 http://www.fco.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1041606042759
to each of those countries” and who “become very knowledgeable about the country they are serving.”\footnote{Q 284} The CSA told us that there were three science and innovation cultural attachés in Brazil, which “does reflect the importance that we attach to our work with Brazil.”\footnote{Q 249} He also said that these three officers were the only ones among the Mercosur countries.\footnote{Q 275}

**The UK-Brazil ‘Year of Science’**

127. The UK and Brazil signed a Joint Plan of Action on Science, Technology and Innovation in March 2006 during the Brazilian President’s state visit to the UK.\footnote{The OSI and the FCO, through the Global Opportunities Fund’s Economic Governance programme, are providing £150,000 in funds funding across the financial years. The CSA talked of “a budget from my office of £100,000 in total, the first £50,000 to assist the Ambassador to establish the Year; the second £50,000 to establish networking arrangements” (Q 255)} The Year is part of this, and covers health, agriculture, climate change, nanotechnology, and science and technology management. The Year intends to “promote co-operation and encourage the development of joint scientific and technological projects in areas of common interest, particularly in relation to climate change, agriculture and health.”\footnote{Appendix 23 (UKTI), para 7.2} The previous Year of Science was with China.

128. The CSA believed that Brazil offered a very significant opportunity, in terms not only of its resources and strategic importance to the UK, but also of the science base that it offers. The CSA outlined the five themes of the programme which was launched at the end of March 2007: “firstly, planet Earth, where we are looking at these issues of climate change, energy, renewables, agricultural science, animal health and biodiversity; secondly, human life; thirdly, reaching beyond, that is stretching into the sciences of the future of nanotechnology and advanced engineering; creativity is the fourth one—digital content, media, design, intellectual property; and then, finally, linking up science co-operation, science policy issues.”\footnote{Q 249} The CSA’s office has seconded a person to help with the Year, which will comprise events such as: a series of public lectures, mostly by UK academics; networking opportunities through science fairs; structured discussions between UK and Brazilian stakeholders on selected areas where there are common interests; and research workshops.\footnote{Q 250} During the CSA’s visit from 26–30 March 2007 he delivered speeches on climate change, discussed climate change aspects of the forthcoming G8 Summit, and he also took part in a number of bilateral ministerial and other visits. Links were made, notably with the Amazonas region in the areas of biodiversity, ecosystem service valuation, co-operation on access to biodiversity, and intellectual property rights.\footnote{Appendix 17 (Office of Science and Innovation)} Also a ‘consultative committee’ is to be established to reach an action plan on partnership...
opportunities that have been identified by the scientists in the CSA’s delegation, and to ensure long-term initiatives last beyond the Year itself.

129. UKTI said that events associated with the Year would also include “a design event in April launched by the Duke of York, and the Lord Mayor opening an event on human life in September.”320 The CSA said that the Year “has to involve both the research sector in our universities and the research sector in our industries and theirs, but also the full panoply of the UK trade and industry interests in raising the profile of British industry in Brazil.”321

130. The Year has to be seen within the wider context of developing trade with Brazil. It features among the fifteen JETCO recommendations, which emphasised the bioscience and nanotechnology sectors. The recommendations also encompassed bilateral co-operation between accreditation and patent organisations,322 and some progress has since been made on this with the organisation of a visit to Brazil by the UK Intellectual Property Office (formerly the Patent Office).323

**Biofuels & Ethanol**

131. Ethanol as a fuel in Brazil dates back to 1925, and there was a boom following the 1973 oil crisis when Brazil made efforts to reduce its reliance on imports of fossil fuels. Ethanol has now replaced 40% of petrol use.324 Brazil has certain comparative advantages in ethanol production. Unlike American or European processes based on crops (e.g. barley, corn or wheat) that must first be converted at significant expense into sugars, Brazilian processes are based on sugar cane, which its climate favours, obviating any need for conversion. Therefore production costs are lower for Brazil: 22 cents a litre, compared with 30 cents for ethanol derived from corn. These low production costs make it a lucrative business for farmers, even without subsidies on the scale of those seen in the US and the EU.325 Over the next five years $12.2 billion of expenditure is planned on 77 new ethanol plants, as well as $2.4 billion for improvements to existing plants; Brazil is expected to have 412 distilleries producing 9.5 billion gallons of ethanol by 2012.326 Over thirty years “sugarcane plantations have been spreading north and west across Brazil’s hinterlands, replacing coffee, citrus and pasture.”327 While less than 20% of Brazil’s ethanol production is exported,328 a Brazilian Ministry of Science and Technology study found that exports could increase from 3 billion

---

320 Appendix 27 (UKTI), annex B
321 Q 270
322 Specifically between the National Institute for Metrology and Industrial Quality (INMETRO) and the United Kingdom National Physical Laboratory (NPL) and United Kingdom Accreditation Service (UKAS), and the National Institute for Industrial Property (INPI) and the United Kingdom Patents Office (UKPO).
323 Appendix 27 (UKTI), annex A, point 4
litres at present to 200 billion litres by 2025, which could replace a tenth of global petrol consumption.329

132. Brazil faces the high trade barriers of the EU and the US.330 Exports to the US face a 54 cent-per-gallon tariff barrier plus a 2.5% ad valorem duty, while Brazil does not benefit from the tariff-free access for ethanol exports under US preference schemes with countries in Central America, the Caribbean and the Andean Community.331 The US also subsidises corn production, and a 51 cent per gallon subsidy for combining ethanol and gasoline is “effectively restricted to domestic producers” due to the tariff.332 The EU, too, has high tariffs on imports of ethanol from Brazil, and its bio-diesel specifications “favour expensive local rapeseed oil” over imports.333

133. At a biofuel ‘summit’ in Brazil in March 2007 the US and Brazil—which together account for more than 70% of global ethanol output—agreed to share research, and cooperate on promoting ethanol production in Central America and the Caribbean, but did not address tariff and subsidy issues.334 In the same month an International Biofuels Forum including Brazil, the EU, the US, China, India and South Africa was set up to develop the world market.

134. Concerns have been raised over the environmental impact of large increases in ethanol production, including deforestation and loss of savannah in Brazil, a growing trend towards monoculture, and air pollution resulting from the burning of sugar cane.335 However, the CSA confirmed that, for producing biofuel, sugar was his preferred option both from an environmental and an economic perspective:

“If you look at the economics of biofuels they are very sensitive to the input feedstock, so sugar cane is easily the best input both from an economic and from a carbon cycle viewpoint. Maize and beet are the alternatives, wheat is another possibility. Now, maize to alcohol is a very inefficient process so economically, for example, it is considerably more expensive and not competitive, but sugar cane to alcohol in those areas of the world—and southern Africa, Brazil, Australia, the West Indies would be examples where the climate would be perfect—would produce very competitive fuels, even at the lower prices today.”336
Also, while 7 million acres in Brazil are devoted to sugar cane production for ethanol “more than 400 million acres of pasture land—none of it in the environmentally sensitive Amazon region—could be cultivated.”

The UK-Brazil-Southern Africa ethanol partnership

Brazil is a world-leader in bio-ethanol technology. In 2005 the CSA saw an opportunity to bring together climate change and African development by encouraging a bio-ethanol sector in Africa using Brazil’s technology, reducing fuel imports and raising revenue. The UK-Brazil-Southern Africa bio-ethanol partnership was agreed by the Office of Science & Innovation in March 2006, concentrating initially on Mozambique. We understand that the partnership has focused on development and helping governments in Africa create the “policy, regulatory and infrastructural framework” for spreading the production and use of such bio-ethanol, both in the processes of converting crops to alcohol and in the use of alcohol in cars using vari-fuel devices. A scoping study on transferring the technology to southern Africa indicated that Mozambique could reduce its oil imports by 40% by shifting some agricultural production to sugar cane for conversion using Brazilian processes.

We welcome the commitment of the UK and Brazil to a bio-ethanol partnership with South Africa, which was reinforced by expressions of support for renewable energy trade and investment partnerships generally, and particularly in ethanol, in the UK-Brazil JETCO recommendations. In doing so we note that criticism is frequently made of Brazil’s bio-ethanol production, including the threat posed to the rainforest. However, all large-scale agriculture has biodiversity implications, and while the rainforest is clearly vitally important, we have been assured that the areas most suitable for sugarcane production are not rainforest areas.

Exploiting bio-diversity

The CSA said that Brazil was funding a £2.5 billion project over ten years to create wealth from its tropical forests, including using their biodiversity in the search for new pharmaceuticals. The CSA also said that he and President Lula felt that, given the UK’s enormous strength in the life sciences, medical sciences and pharmaceutical sciences, the UK would be Brazil’s preferred partner in this area. He noted, for example, Brazil’s prowess in developing effective vaccines, but added that IPR issues “protecting the wealth creating processes that emerge” would need to be addressed.
138. In science, as we have discovered in other areas, Brazil receives less attention than China and India. We hope that the Year of Science will ensure due weight is given to Brazil’s strengths in life sciences in particular, and to the possibilities for mutually beneficial co-operation between Brazil and the UK. We fully support the Year of Science with Brazil, and hope that it will not only contribute to a better understanding of the potential of Brazil in science, but also result in a positive spill-over effect into the general UK-Brazil trade and investment relationship.
5 Argentina, Paraguay, Uruguay & Venezuela

139. We have concentrated on Brazil as the largest member of Mercosur, but we have seen evidence of significant opportunities for UK companies in the bloc’s other members, most notably Argentina, but also Uruguay. We received little evidence on Paraguay and, as new member Venezuela is in a transition period, we have therefore focused on Argentina and Uruguay.

Argentina

140. After Brazil, Argentina is Latin America’s second largest country by area, with a population of around 38.7 million in 2005. Argentina has endured a boom and bust past, most recently a recession following ‘contagion’ from the 1998 Asian financial crisis, and then the 2001/02 financial crisis which saw high inflation, large government deficits, a loss of investment confidence, controls imposed on withdrawals of bank deposits, and social unrest, followed by the largest ever sovereign debt default in January 2002.

141. Since the default, the end of convertibility between the Argentine peso and the US dollar, and the subsequent devaluation, the exchange rate has stabilised, as has the economy generally. Argentina has recently seen strong economic growth, of 8.8% in 2003, 9.0% in 2004 and 9.2% in 2005, with forecasts of 7.0% in 2006 and 4.5% in 2007. After its past debt problems it decided to repay its International Monetary Fund debts of $10 billion in January 2006, although it still has World Bank and other debts. Yet Argentina suffers from fears of an economic relapse, and it remains unclear whether it has escaped the boom-bust cycle, with inflation and energy being two key issues facing the economy.

Trade relations with the UK

142. After Mexico and Brazil, Argentina is the UK’s third largest market in Latin America, with UK exports now recovering from a dip caused by the 2002 economic crisis and subsequent Argentine devaluation. The UK’s total goods exports to Argentina were valued at almost £169 million in 2005, and imports at £290 million. UKTI told us that in the first half of 2006 UK exports were valued at £106.8 million, compared to £81 million for the same period in 2005 (up 32%), while UK imports were valued at £170.4 million compared with £119.4 million (up 43%).

143. The UK is Argentina’s 14th largest trade partner: its 12th largest source of imports, consisting primarily of machinery and transport equipment, chemicals and related products, and its 22nd largest export market, mainly of food, live animals, beverages and tobacco. The UK is also the top export destination for Argentine bottled wine. Among

---

345 Appendix 23 (UKTI), annex J
346 Ibid.
347 UKTI country profile (background page): https://www.uktradeinvest.gov.uk/ukti/appmanager/ukti/countries
EU countries, in 2005 the UK was the 5th largest goods exporter to Argentina after Spain (whose exports were valued at over three times as much as the UK), the Netherlands, Italy and Germany, and also the 5th largest goods importer from Argentina after Germany, Italy, France and Spain.  

144. The UK has a long history of investment in Argentina, and UKTI told us that the UK is the 6th largest inward investor, with over $2 billion invested over the past three years. The main sectors are pharmaceuticals (notably GlaxoSmithKline, and AstraZeneca), banking (HSBC), mining (Rio Tinto and Anglo Gold), and energy (BG Group, BP and Shell).

**Opportunity sectors**

145. As with Brazil, Argentina offers opportunities while having significant barriers that must be overcome. As UKTI put it, despite a “difficult economic climate, Argentina continues to offer significant trade opportunities for UK companies.” According to the World Bank, Argentina is an easier place to do business than Brazil: 101st compared with Brazil in 121st position in 2006. In their evidence, Argentina’s Investment Promotion Agency (ADI) outlined a number of reasons to invest in the country, including:

— its potential for strong economic growth;
— various investment incentives, particularly regarding duties on imports of capital goods and software industry tax incentives;
— its access to international markets;
— its competitive and qualified workforce, with high literacy levels and low labour costs;
— infrastructure and natural resource availability;
— its relatively low costs of investing; modern diversified industry; open economy with strong foreign investment;
— its favourable legal framework for foreign investment;
— and a good internal market.

146. UKTI identified the most promising opportunities in the key Argentine export sectors as agriculture, mining, petrochemicals and the creative industries—which it believes will be the main growth sectors in 2006/07, along with financial and legal services, oil and gas, and media sectors. It considers there are further opportunities in pharmaceuticals,
biotechnology and healthcare, as well as in banking, insurance, reinsurance, investment funds, capital markets, and PPP/PFI. The sixty-member British Argentine Chamber of Commerce (BACC) considered infrastructure, energy, transport, tourism and agribusiness as opportunity sectors.\(^\text{354}\) The Lord Mayor also noted interest in PPP and carbon trading during his September 2005 visit.\(^\text{355}\) A trade mission to Argentina led by the Law Society was due to take place in May 2007 to promote English legal services.\(^\text{356}\) The CSA also noted that, like Brazil, Argentina has “a very good record in science and technology”.\(^\text{357}\) The Trade Minister identified ICT as a potential growth area, noting that a “number of companies have already established themselves in the marketplace”.\(^\text{358}\) During our visit we were also informed of Argentina’s strength in ICT, with a number of large companies operating out of Buenos Aires and strong skills and range of languages available; UKTI noted that the sector was “fairly impressive”, with software exports now outstripping wine exports.\(^\text{359}\)

147. On science, the CSA told us that spending in Argentina did not match Brazilian levels, but said that, like Brazil, “Argentina ought to be high on our strategic considerations”, in view of the potential for scientific collaborations between the UK and Argentina.\(^\text{360}\) However, during out visit we found that the exchange rate has made study in the UK a difficult option for students from Argentina, and that the British Council’s Chevening scholarships are widely sought after by students looking to study in the UK.

148. Unlike the case of Brazil, a bilateral Investment Promotion and Protection Agreement has been in force with Argentina since 1993, and the UK also has a double taxation agreement with Argentina.\(^\text{361}\) The UK and Argentina also have a Memorandum of Understanding on financial rules and regulations, agreed in May 2001.\(^\text{362}\)

**Barriers & issues**

149. While there are opportunities in Argentina as outlined above, there are also a number of barriers to trade and investment, including taxes and tariffs, and difficulties over intellectual property rights protection and language, while economic risks are seen in terms of high inflation and energy security (explored in more detail below). Some companies suffered heavily due to Argentina’s economic crisis, which is reflected in general perceptions of Argentina as a place in which to invest. Utility companies endured effective price freezes despite the end of peso-dollar convertibility and subsequent devaluation,

---

354 Appendix 5 (British Argentine Chamber of Commerce)
355 Appendix 12 (Corporation of London), paras 10-11
356 ‘New mission to bolster legal links with Argentina’, *Law Society Gazette*, 22 March 2007, p 8
357 Q 277
358 Q 199
359 Appendix 26 (UKTI)
360 Q 277
361 Effective in UK from April 1998 (for corporation tax, income tax and capital gains tax) and in Argentina from January 1998 (see [http://www.hmrc.gov.uk/international/argentina-dtc.pdf](http://www.hmrc.gov.uk/international/argentina-dtc.pdf))
362 Appendix 26 (UKTI)
which the CBI noted created real problems.\textsuperscript{363} The banking sector was also hit by the crisis, with HSBC estimated to have lost over $1 billion.\textsuperscript{364} UKTI also stated that a number of investors, including UK companies, mostly from privatized utility companies, have outstanding international arbitration claims against Argentina.\textsuperscript{365}

**Taxes & tariffs**

150. The Lord Mayor told us that tax evasion was “endemic” in Argentina, with the system “skewed to those areas where collection is easiest”, such as export tariffs which are levied at up to 23\%.\textsuperscript{366} Unsurprisingly, as they share most tariffs through the Mercosur common external tariff, Argentina has high import tariffs like Brazil. Bound tariffs, the maximum level permitted by the WTO, average over 31\%, and although the tariffs actually applied were below this level they were significantly above EU levels, averaging 12.2\% in 2006 (10.1\% on agricultural products, and 12.6\% on industrial products).\textsuperscript{367} The CBI also noted that Argentina levies a value-added tax of 3\% on domestic goods, but 10\% on imported goods which they believe could be violating WTO rules which state that taxes on imports should not exceed those on similar goods produced within the country.\textsuperscript{368}

**Inflation & price controls**

151. Inflation is widely regarded as a key issue, amid concern about whether the high growth experienced over the past few years can be sustained without inflation;\textsuperscript{369} it is likely to be important in October 2007’s presidential election. While in Argentina we learned of the widespread belief that official price indices do not reflect reality, and that the prices of items in the official basket of goods are tightly controlled while those of similar goods are not. *The Economist* noted the official monthly inflation rate in January 2007 was 1.1\%, below estimates of ‘true’ inflation of between 1.5 and 2.0\%, and that prices of non-controlled goods were expected to rise by 13–15\% in 2007.\textsuperscript{370}

152. The Argentine Government’s so-called price “agreements” with businesses—tantamount to price controls—were the subject of widespread complaint during our visit. Unconventional means appear to have been used to enforce these controls, for example UKTI told us that President Kirchner “encouraged a blockade against Shell in February 2005 after the company decided to raise petrol prices.”\textsuperscript{371} We were surprised to hear that the Trade Minister was not aware of the problems relating to price controls

\textsuperscript{363} Q 118  
\textsuperscript{364} Appendix 12 (Corporation of London), para 8  
\textsuperscript{365} Appendix 23 (UKTI), annex J  
\textsuperscript{366} Appendix 12 (Corporation of London), para 7  
\textsuperscript{368} Appendix 11 (CBI), para 11  
\textsuperscript{369} e.g. Lord Mayor, Appendix 12 (Corporation of London), para 7, and Appendix 23 (UKTI), annex J  
\textsuperscript{370} ‘Cooking the books – Inflation in Argentina’, *The Economist*, 10 February 2007  
\textsuperscript{371} Appendix 23 (UKTI), annex J
in Argentina, as in their evidence to us UKTI had cited “Argentine government intervention, including price control” as an example of an internal barrier to trade faced by UK companies. These price controls risk deterring UK investment in Argentina.

**Energy issues**

153. There are also concerns that energy security issues jeopardise Argentina’s continued strong growth, which the Lord Major said was “hampered by a severe lack of capacity in the energy sector, despite the strong demand.” The question of price control appeared to be acute in the energy industry and, as UKTI said, “particularly, though not exclusively” in the oil and gas sector. The Argentine power grid is struggling to cope with demand, especially given the rapid rate of recent economic growth; and investment in greater capacity is being deterred by the fact that energy tariffs have been frozen since 2002, leading to domestic prices 50% below international prices. In March 2007, the Financial Times website stated that “most are afraid to criticise the government’s distortionary policy openly, despite the fact that Argentina’s oil and gas reserves are rapidly dwindling while a fast-growing economy and bargain prices mean demand for energy is higher than ever.” After the chief executive of the Brazilian state-owned oil company Petrobras voiced concerns that energy price freezes were discouraging investment, the Argentine planning minister said that its contracts could be seriously affected should it fail to invest sufficiently. Shell has previously incurred a £3.5 million Government fine for allegedly failing to provide the domestic market with adequate supplies.

**IPR**

154. The European Commission recently listed Argentina, along with Brazil and Paraguay, as countries where future deeper trade relationships would include a stronger focus on IPR enforcement. Although, as noted above, Brazil was recently demoted from the US ‘priority watch list’ for intellectual property rights enforcement, Argentina remains on the list, with the main issues being pharmaceuticals patent and copyright infringements, although progress in reducing the patent application backlog and bilateral co-operation has been recognised. Though it does acknowledge “recently implemented fast-track

---

372 Qq 200-202
373 Appendix 26 (UKTI), para 24
374 Appendix 12 (Corporation of London), para 7
375 Appendix 26 (UKTI), para 24
376 ‘Argentina’s energy bust-up’ from Financial Times, FT.com (via Factiva) 25 March 2007
377 Ibid.
378 ‘Soaring temperatures and frozen electricity tariffs put unbearable heat on Argentina’s powergrid’, Financial Times, 3 January 2007, p6
procedures for consideration of patent applications and the hiring of a significant number of patent examiners,” the CBI noted that there was a “substantial patent backlog” in Argentina.  

**Other issues**

155. UKTI told us that in the longer term Argentina’s economic recovery would require structural reforms: “combating tax evasion, excessive bureaucracy, corruption and an inefficient judiciary system will be essential to improve Argentine competitiveness. Improvements in legal and judicial security are needed to attract, and maintain, foreign investment.” We agree. As in Brazil, local partners are considered important in Argentina, with multinationals investing in the telecommunications and energy markets in conjunction with local private investors.

156. The CBI also noted other issues in Argentina, including employment law, dealing with licences and starting a business. Language was also seen as a barrier, particularly for smaller exporters, as promotional material and labelling needed to be translated into Spanish. UKTI also seemed undecided to what extent Argentina could be seen as a means of access to the other Mercosur member countries or to Latin America more generally, stating at one time that a presence in Argentina may help access to other Spanish-speaking Latin American markets, and on another that Argentina was not generally viewed as a beachhead for Latin America.

**UKTI support**

157. Argentina has the second largest UKTI resource in the Mercosur countries, with 7.8 full-time equivalent staff. While this is expected to remain unchanged despite the shift in UKTI’s focus, we were surprised to find that Argentina was not included in its 15-strong emerging markets category. Emerging market status is based on various criteria, such as demographics, education and growth, and UKTI includes Brazil and Mexico in Latin America, and also South Africa, in this list. When asked about this omission the Trade Minister said that at present it was “not quite at the level of these other markets, but that does not mean it will not get there.” The last DTI ministerial visit to Argentina was in October 2000, compared with September 2006 for Brazil. Although sensitivities around

---

382 Appendix 11 (CBI), 15
383 Appendix 23 (UKTI), annex J
385 Appendix 10 (CBI), para A7
386 Appendix 11 (CBI)
387 Qq 70 and 83
388 Appendix 25 (UKTI)
389 Q 209
390 HC Deb, 19 March 2007, col 637W
the Falkland Islands obviously remain, and will be heightened during this 25th anniversary year of the conflict, the fact remains that Argentina is a country with strong European roots in which Britain has played an important part over many years and in which Britons feel very much at home. The British Argentine Chamber of Commerce informed us that UKTI financial support for outward missions to Argentina had been withdrawn in 2005 after changes in government support for export promotion.\textsuperscript{391} We believe that this decision should be reconsidered in the light of Argentina’s future potential. The BACC also say that they would “welcome the opportunity of working closer with UKTI and having better communication in order to help British companies understand and identify opportunities in Argentina”. We support this suggestion.

\textbf{Uruguay}

158. Uruguay has suffered from the economic crises experienced by its larger neighbours Argentina and Brazil in the past, but as UKTI told us: “Uruguay’s hallmarks are political stability and low corruption, combined with an open financial system. These are important assets, given the relative instability of some of Uruguay’s neighbours”. Uruguay’s other advantages include the highest literacy level in Latin America, with high education levels and good universities.\textsuperscript{392} The World Bank also ranks Uruguay highest among Mercosur members for ease of doing business, at 64\textsuperscript{th} out of 175 countries. The Economist has even suggested that Uruguay could be “the new Chile”, citing its successes in farming, tourism and finance.\textsuperscript{393}

159. Uruguay’s main export is meat, as well as other agricultural products including vegetables, citrus, rice and soya. Uruguay is the UK’s 105\textsuperscript{th} export partner\textsuperscript{394} while the UK is Uruguay’s 16\textsuperscript{th} most important supplier of imports, of which a high proportion is accounted for by Scotch whisky. The UK’s share of the Uruguayan market is 2\%.\textsuperscript{395} Among EU countries the UK ranked 5\textsuperscript{th} for goods exports to Uruguay in 2005 and 4\textsuperscript{th} for goods imports from Uruguay.\textsuperscript{396}

160. The main growth sectors in 2006/07 as identified by UKTI were agriculture, food and beverages, tobacco and chemicals.\textsuperscript{397} UKTI also cites “longstanding commercial ties” between the UK and Uruguay,\textsuperscript{398} believing the market to offer “worthwhile business opportunities”.\textsuperscript{399} It notes: “Research and preparation are essential to succeed against stiff

\textsuperscript{391} Appendix 5 (British Argentine Chamber of Commerce)
\textsuperscript{392} Appendix 26 (UKTI)
\textsuperscript{393} ‘The next Chile – Uruguay’, The Economist, 3 February 2007
\textsuperscript{394} In 2005, from Appendix 24 (UKTI), annex 3 para 8 (table).
\textsuperscript{395} Appendix 26 (UKTI), para C2
\textsuperscript{396} Ibid, para F3
\textsuperscript{397} HC Deb, 24 Jan 2007, col 178SW
\textsuperscript{398} UKTI online Uruguay country profile (accessed May 2007)
\textsuperscript{399} Appendix 26 (UKTI), para C2
competition, but niche markets can often be found. Uruguay is well worth considering for experienced exporters and those already doing business elsewhere in Latin America."400

161. UKTI states that opportunities are available in pharmaceuticals, telecommunications, IT, agribusiness and machinery.401 It sees Uruguay’s biggest asset as its access to the Mercosur markets. For example: "Uruguay is a services-oriented country, taking advantage of its key location between Argentina and Brazil. As a consequence, the country has developed a large financial sector to provide services to residents of the surrounding countries."402 While we saw strong ICT sectors in both Brazil and Argentina, Uruguay is the biggest Latin American software exporter, although Brazil produces more.403 Software companies are able to benefit from the tax incentives available in Uruguay’s Free Trade Zones even if they are not based in these zones, although UKTI said that the zones themselves also offer a “stable policy framework, good telecommunications and logistic facilities”.404

162. Indian IT consulting company Tata Consultancy Services opted to base a Global Development Centre in Montevideo from which it serves its Latin American clients. It based its decision on education levels, foreign language skills (both English and Portuguese), the stable political environment, the high quality of living and the government’s willingness to allow employees to be brought in from abroad.405 LINPAC Uruguay considered that the country has “a long-standing reputation for reliability among foreign investors”, and noted its legal system, transparent and open market, strong regulatory framework, duty- and quota-free access to other Mercosur markets, equal treatment of local and foreign workers, lack of restrictions on foreign nationals on boards (unlike other Mercosur countries), free circulation of capital and remittances abroad, its good ports, airports and links to Argentina and Brazil, the bilateral UK-Uruguay IPPA, high literacy levels, and Uruguay’s “pro-UK” attitude. LINPAC also pointed out that there were a number of foreign companies that had used Uruguay’s Free Trade Zones to site their regional Mercosur hubs.406

163. The asymmetries (of area, population and economy) inherent in the Mercosur bloc are a major issue for Uruguay. While there have been recent initiatives to try to offset this, these may not be sufficient to deflect Uruguay from ultimately pursuing a bilateral trade agreement with the US, which would almost certainly require it to leave Mercosur and perhaps become an associate member, like Chile.407 The Economist cites Uruguay’s membership of Mercosur, and therefore its inability to conclude bilateral free trade

400 UKTI country profile (main page); https://www.uktradeinvest.gov.uk/ukti/appmanager/ukti/countries?_nfls=false&_nfpb=true&_pageLabel=CountryTyp e1&navigationPageId=uruguay
401 Appendix 26 (UKTI), para C2
402 Ibid.
403 Ibid.
404 Ibid.
405 Ibid.
406 Appendix 15 (Linpac Plastics)
407 ‘Uruguay threatens to downgrade its status in Mercosur’, Financial Times, 9 March 2007, p8
agreements directly with its trade partners, as one of two barriers to recreating Chile’s economic success, with the other barrier being domestic political restraints on economic liberalisation and reform.408

164. In terms of UKTI resources, there has been a small team of 1.9 full-time equivalent staff operating in Uruguay, which is a service level agreement market, meaning that “only limited UK government support is provided, including responding to commercial enquiries; lobbying in support of UK firms; responding to, and supporting, of British business visitors; and supporting British businesses established in the market.”409 However, UKTI will withdraw from Uruguay from the end of March 2008. There will then no longer be a UKTI commercial presence in Uruguay, although case-by-case lobbying for commercial purposes will continue to be carried out by the Ambassador.410 This decision is in part due to the reassessment of UKTI’s priorities following the new strategy to focus on key emerging markets such as Brazil. The effects on Mercosur more broadly are looked at separately below.

165. We are concerned that the UKTI service for Uruguay will share the fate of that for Paraguay, which no longer has a UKTI presence and for which very limited information was available for this inquiry. This move seems perverse, given the strong historic ties of friendship between the UK and Uruguay, the country’s benign business environment, that UK companies are choosing to invest in Uruguay as a base from which to access other South American countries, the high level of inquiries received relating to Uruguay (see paragraph 173) and that the institutions of Mercosur are based in Montevideo. We are unconvinced that it will prove possible to provide sufficient quality of cover from other neighbouring posts and we therefore urge UKTI to reverse its decision to remove its commercial presence from Uruguay.

Paraguay

166. We received little information on Paraguay, and so we are able to make only general comments about the country. This is in part because UKTI has had no direct presence there since the British Embassy was one of eight closed after the 2004 Spending Review. As UKTI and the Trade Minister told us, this is a reflection of the fact that Paraguay was ranked as the UK’s 144th export partner in 2005.411 There is an Honorary Consulate in Asunción, but Paraguay is covered from Buenos Aires and UKTI offers little support other than “lobbying and political support by the Ambassador in Buenos Aires on a case-by-case basis”.412 Although the Foreign Office’s web-page on the country gives limited economic and commercial information, the UKTI website has even less information. While a recent written answer on the main sectors in the Mercosur countries gave detail for the other member countries, on Paraguay it only stated that it “does not have any dedicated UKTI

408 ‘The next Chile – Uruguay’, The Economist, 3 February 2007
409 Appendix 26 (UKTI), annex C2
410 Appendix 27 (UKTI), annex O5
411 In 2005, from Appendix 24 (UKTI), chapter 3 para 8 (table).
412 Appendix 23 (UKTI), annex A
resource to deal with commercial enquiries. However, the dominant sector is agriculture.”

Although we accept that limits on its resources mean that UKTI must make choices between markets globally, we believe that while Paraguay may not merit a full service there should at a bare minimum be basic market and sectoral information available through the UKTI website, particularly when information is available on the website of one of its parent departments.

167. In recent years Paraguay has seen growth of 3.5–4%, accompanied by policies to combat inflation, strengthen public finances, and reduce public debt down towards 30% of GDP. The Foreign Office states that the agriculture and agro-industry account for 30% of economic output and 95% of exports, and offer “worthwhile opportunities for British exporters and investors”. UK companies are operating in Paraguay, including Lloyds TSB, Shell, Unilever, Diageo, and a local agent for Land Rover. The UK’s main exports are primarily alcoholic beverages, along with textiles, road vehicles, organic chemicals, power generating machinery and equipment, and chemical materials. The UK’s main imports are sugar, cork and wood, beverages, organic chemicals and clothing. Among EU countries the UK ranked 4th for goods exports to Paraguay in 2005, but 9th for goods imports. Paraguay is trying to increase exports of agricultural and handicraft products through PROPARAGUAY, its trade promotion body. UKTI outlined concerns about IPR infringements and smuggling of a range of goods from Paraguay intended for resale to tourists under a preferential tax regime. The CBI also said that Paraguay was “a major source of counterfeit goods”. Paraguay is listed by the European Commission as a country where future deeper trade relationships would “include higher focus on IPR enforcement”, while the US has highlighted IPR concerns in Paraguay and continues to monitor the situation.

168. Like Uruguay, Paraguay is economically dominated by Brazil and Argentina, and UKTI noted that it “has been unable to redress the unilateral trade restrictions, imposed by Argentina and Brazil, through Mercosur and this has resulted in increased opposition within Paraguay to Mercosur during the past few years.” Unlike in the case of Uruguay we received no evidence of UK companies using Paraguay as a base to access the larger markets through the Mercosur common market.

---

413 HC Deb, 24 Jan 2007, col 1785W
414 ‘Statement by Mr. Anoop Singh, Director of the Western Hemisphere Department of the International Monetary Fund (IMF) at the Conclusion of His Visit to Paraguay’, IMF press release 06/268, 5 December 2006 [http://www.imf.org/external/np/sec/pr/2006/pr06268.htm]
415 Appendix 26 (UKTI), F2
416 www.proparaguay.gov.py
417 Appendix 26 (UKTI)
420 US Trade Representative, 2007 Special 301 Report, p40
421 Appendix 26 (UKTI)
Venezuela

169. As a new Mercosur member, Venezuela is in a transition period from its former Andean Community membership. Its integration into Mercosur is phased: tariffs with Argentina and Brazil are to be removed by 2012, with preferential access for main imports from Paraguay and Uruguay offered immediately and free trade by 2013, and a requirement to adopt the Mercosur common external tariff in four years. UKTI commented that some sectors are protected during the transition process, such as food, livestock, software, electronic equipment and automobiles. As the CBI noted, "Venezuela will now need to undertake important work to implement Mercosur trade rules and regulations, including adopting the bloc’s Common External Tariff, and to transpose Mercosur’s agreements with third countries into its domestic legislation."

170. We received limited evidence on the country and the potential impact of its accession, although one might expect Venezuela’s accession to Mercosur to change the course of the bloc’s development. There are potentially greater political risks involved in a Mercosur with Venezuela as a member. President Hugo Chávez was recently re-elected for a third six-year term, having raised concerns among businesses that various strategic industries could be nationalised. While there have been some nationalisations, which have seen at least some companies adequately compensated, it is currently unclear how nationalisation policy will develop.

171. The World Bank ranks Venezuela even lower than Brazil for doing business—164th out of 175, compared with 121st for Brazil. UK companies are present in Venezuela, including BP, Shell, Wood Group, Holcol, GlaxoSmithKline, Diageo and Unilever. In 2005, total UK exports of goods and services to Venezuela were valued at £329 million, and imports of goods and services at £418 million. Among EU countries the UK was the 3rd largest goods importer from Venezuela in 2005, after Spain and the Netherlands, and 4th for goods exports. The main UK goods exports are chemicals, beverages, and medicinal and pharmaceutical products. UKTI has identified the main growth sectors for 2006-07 as: oil and gas, agriculture, construction, consumer goods, education and training, environment, financial services, ICT, power, security, and tourism. Like Brazil, Venezuela is a UKTI priority market for oil and gas, with opportunities for UK businesses available through minority-share joint ventures, strategic associations and profit sharing agreements.
Bolivia

172. Bolivia, currently an associate member of Mercosur, has also requested to become a full member. However, this would mean adopting the Common External Tariff which averages 12%, higher than Bolivia’s average 5% tariff. In January 2007 the Mercosur countries agreed to consider Bolivia’s application in a working party, with a decision not expected until mid-2007 or early 2008.

UKTI resources across the Mercosur countries

173. Across Mercosur, UKTI has identified only Brazil and Venezuela as priority markets in the oil and gas sector. The level of UKTI resources across the countries in the bloc reflects the organisation’s prioritisation and the relative importance of each for UK trade:

Figure 9: UK goods trade with Mercosur countries, 2005

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th></th>
<th>Imports</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£ million</td>
<td>Rank</td>
<td>£ million</td>
<td>Rank</td>
</tr>
<tr>
<td>Argentina</td>
<td>169</td>
<td>69</td>
<td>291</td>
<td>65</td>
</tr>
<tr>
<td>Brazil</td>
<td>840</td>
<td>35</td>
<td>1,771</td>
<td>32</td>
</tr>
<tr>
<td>Paraguay</td>
<td>12</td>
<td>144</td>
<td>1</td>
<td>179</td>
</tr>
<tr>
<td>Uruguay</td>
<td>37</td>
<td>105</td>
<td>59</td>
<td>92</td>
</tr>
<tr>
<td>Venezuela</td>
<td>236</td>
<td>56</td>
<td>395</td>
<td>56</td>
</tr>
</tbody>
</table>

Source: Appendix 23, annex L

174. We noted earlier that Brazil has been a beneficiary of the increased resources available to key emerging markets under UKTI’s new strategy. However, as figure 10 illustrates, after a slight increase in total resource to 2007/08 UKTI’s withdrawal from Uruguay in 2008/09 will see total resources across the bloc almost unchanged from their 2005/06 level. Indeed, across the whole of South America UKTI resources are to fall by 1.5 full-time equivalent staff.

431 Financial Times (ft.com), 15 January 2007
432 See Chapter 2.
### Figure 10: UKTI staff (full-time equivalent) employed in Mercosur countries

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>7.8</td>
<td>7.8</td>
<td>7.8</td>
<td>7.8</td>
<td>7.8</td>
</tr>
<tr>
<td>Brazil</td>
<td>39.0</td>
<td>38.0</td>
<td>41.0</td>
<td>41.0</td>
<td>41.0</td>
</tr>
<tr>
<td>Paraguay</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Venezuela</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Uruguay</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Mercosur total</strong></td>
<td><strong>53.7</strong></td>
<td><strong>52.7</strong></td>
<td><strong>55.7</strong></td>
<td><strong>53.8</strong></td>
<td><strong>53.8</strong></td>
</tr>
<tr>
<td><strong>South America total</strong></td>
<td><strong>76.0</strong></td>
<td><strong>74.4</strong></td>
<td><strong>77.4</strong></td>
<td><strong>74.5</strong></td>
<td><strong>74.5</strong></td>
</tr>
</tbody>
</table>

*Source: HC Deb, 6 Feb 2007, col 904W*

### Figure 11: UKTI substantive enquiries received, 2005/06

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of enquiries</th>
<th>Enquiries per staff member</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>36</td>
<td>4.6</td>
</tr>
<tr>
<td>Bolivia</td>
<td>10</td>
<td>4.5</td>
</tr>
<tr>
<td>Brazil</td>
<td>471</td>
<td>12.1</td>
</tr>
<tr>
<td>Chile</td>
<td>144</td>
<td>21.5</td>
</tr>
<tr>
<td>Colombia</td>
<td>9</td>
<td>2.0</td>
</tr>
<tr>
<td>Ecuador</td>
<td>5</td>
<td>1.5</td>
</tr>
<tr>
<td>Peru</td>
<td>10</td>
<td>2.2</td>
</tr>
<tr>
<td>Uruguay</td>
<td>252</td>
<td>132.6</td>
</tr>
<tr>
<td>Venezuela</td>
<td>79</td>
<td>15.8</td>
</tr>
</tbody>
</table>

*Source: Appendix 24 (UK Trade & Industry) annex Q and HC Deb, 6 Feb, 2007, col 904W (2005/06 data)*
175. The Minister told us that Paraguay and Uruguay were ranked 144th and 105th as UK marketplaces, arguing: “The reality is that there is a finite amount of resources and we are investing to get the best bang for our buck, and quite frankly that is the best way to do it.”\footnote{Q 243} He also said that companies looking at these two countries “will get a service but a different one.”\footnote{Q 232} However, UKTI figures show that Uruguay was second only to Brazil in terms of the number of substantive enquiries received from businesses in 2005/06, and in terms of enquiries per full-time equivalent member of staff (also in 2005/06) Uruguay ranks highest by far among the countries for which data were supplied (see Fig. 11).\footnote{No data were available for Paraguay}

176. On UKTI support, the CBI said that “if the market can be effectively served, either through honey-potting\footnote{‘Honey-potting’ refers to focusing resources on fewer posts with broader remits or functions.} or through regional hubs […] then that need not necessarily be detrimental to business interests.”\footnote{Q 136} They noted that, among the original Mercosur members, “Brazil is where the key opportunities are, Argentina has some issues in and of itself and, to be honest, we do not get a lot of inquiries on the other two.”\footnote{Ibid.} The Government’s recent Latin America Strategy states that, as it had been identified as an emerging market, Brazil would “be the focus of UKTI’s efforts to deepen trade and investment relationships […] transferring significant resources from mature markets to increase the UK’s impact in these important high growth economies.”\footnote{FCO, Latin America to 2020: A UK Public Strategy Paper, para 67} While we welcome the decision to increase UKTI resource in Brazil, this increase is very modest indeed. It also appears to be coming entirely at the expense of UKTI’s commercial presence in Uruguay. While we accept that Uruguay is not one of the UK’s largest trade partners in terms of rankings, that UKTI has insufficient resources to cover every country, and that the bulk of resource is said to be being transferred from developed US and European markets, Uruguay can scarcely be defined as a ‘mature market’. Moreover, Uruguay’s significance to UK business may increase if in the future Mercosur’s institutions develop, as these are based in the Uruguayan capital, Montevideo. Should Mercosur develop more fully, a reassessment of UKTI resources would be essential.

177. We also note the view expressed by British Expertise that the greatest opportunities may not be in Brazil but in the smaller countries in the region.\footnote{Appendix 7 (British Expertise)} UKTI must ensure that while focusing on key emerging markets like Brazil it does not miss out on opportunities available from smaller markets in Mercosur and Latin America more generally and ensure that it transmits these opportunities to UK businesses.
Mercosur’s future, trade relations with the EU, & the Doha Round

Challenges ahead for Mercosur

178. Mercosur is widely thought to be modelled on the European Union, yet although some see it as an embryonic ‘EU in South America’ its level of integration falls some way short of that of the EU. Even within the Mercosur countries themselves, we noted that there was a considerable degree of scepticism about the future of the organisation. Mercosur faces significant challenges as its development has been hindered by national interests, internal asymmetries, and disputes between members which have even been taken to the WTO. The Argentine and Brazilian economic crises, subsequent devaluations and trade disputes have been politically problematic for Mercosur.

179. For example, there is a continuing dispute between Argentina and Uruguay over a $1.7 billion paper mill being built by a Finnish company—“the largest ever private investment in the country”\footnote{Finnish Botnia Plant To Start Operating Aug 2007 - Uruguayan Minister, Latin America News Digest (via Factiva), 23 March 2007}, equivalent to 10% of its GDP\footnote{Court paves way for pulp mills in Uruguay', Financial Times, 14 July 2006}—on the Uruguay River, which forms the border between the two countries. Argentina claims that it will be environmentally damaging and contravenes a bilateral treaty. The associated blockades of bridges over the river are thought to have cost Uruguay $800 million in tourism and trade, equivalent to 4% of Uruguay’s GDP\footnote{Mill dispute with Argentina costs Uruguay more than $800m', Financial Times, 6 February 2007}. This dispute has proved intractable, with Argentina taking Uruguay to the International Court of Justice in The Hague, and Uruguay going to the Court of Mercosur claiming that the blockades contravene the bloc’s free movement of goods principle.\footnote{Finnish Botnia Plant To Start Operating Aug 2007 - Uruguayan Minister, Latin America News Digest (via Factiva), 23 March 2007} While inter-bloc trade disputes are not unique to Mercosur (other examples include the lumber dispute cases between Canada and the US through both NAFTA and the WTO) some have seen Brazil’s apparent reluctance to mediate over the pulp mill issue as an indictment of Mercosur’s ability to deal with disputes.

180. The British Chambers of Commerce in Brazil suggested that each of the member countries should be treated separately because “Mercosur does not act together”.\footnote{Appendix 6 (British Chamber of Commerce in Brazil), para 1.3} The UN has also highlighted the lack of macroeconomic co-ordination within Mercosur, despite agreements in 2000 to do this and adopt deficit, debt and inflation targets, saying that “the development of sufficient incentives for compliance with the declared goals proved to be difficult, and, following the Argentine crisis in 2001, this endeavour came to an end.”\footnote{United Nations, World Economic Situation and Prospects 2007, January 2007, pp79-80: http://www.un.org/esa/policy/wesp/wesp2007files/wesp2007.pdf}
181. The UK Government is supportive of regional integration, but the Trade Minister emphasised that the development of Mercosur “will be at their pace”\textsuperscript{447} and that it was “not for us to intervene in any way”.\textsuperscript{448} The CBI said that as an example of increasing regionalisation Mercosur “certainly is very, very important, and it is important for business because it reduces the barriers to trade within a region and to investment within that region, and that thereby has an escalating effect in terms of the investment that goes into that region.”\textsuperscript{449} However, there were “issues currently with the degree of integration”, particularly regarding investment and services.\textsuperscript{450}

182. UKTI noted that, while the customs union should mean access to other countries “in practice, this opportunity seems to be viewed more as a peripheral benefit than either a determining factor in investment decisions or an attractant to the Brazilian market in its own right.”\textsuperscript{451} UKTI’s understanding was that “companies target Brazil for the size and sophistication of the domestic market and not primarily as a gateway to wider Mercosur. […] UK companies seeking to adequately service the Brazilian market are unlikely to have the capacity to simultaneously seek to penetrate the rest of Mercosur.”\textsuperscript{452} UKTI attributed this to a number of factors including the lack of a genuine Mercosur single market,\textsuperscript{453} and said it was “perceived as unlikely that UK companies (with an interest in Brazil) will decide to operate from another country—instead of entering the Brazilian market directly.”\textsuperscript{454}

\textit{Imperfect customs union & external tariffs}

183. Mercosur has been called an ‘imperfect customs union’, with estimates that the common external tariff covers around 80% of products, with a range of exceptions including for sensitive products.\textsuperscript{455} There are varying estimates of the exact proportion of total trade within Mercosur that is free of tariffs, but UKTI suggested that this was over 95%.\textsuperscript{456} In line with their relative economic situation, both Paraguay and Uruguay have special arrangements under the transition arrangements towards the common external tariff (CET).

184. Despite past agreements to consolidate the CET and remove unilateral restrictions on free trade between them, such imperfections persist. The CBI told us that the CET “still contains many exceptions and certain restrictions remain available to Mercosur member countries. Meanwhile, trade in services, public procurement, tax and investment policies

\begin{itemize}
\item \textsuperscript{447} Q 151
\item \textsuperscript{448} Q 152
\item \textsuperscript{449} Q 137
\item \textsuperscript{450} \textit{Ibid.}
\item \textsuperscript{451} Appendix 26 (UKTI), para 9
\item \textsuperscript{452} \textit{Ibid.}, para 10
\item \textsuperscript{453} \textit{Ibid.}
\item \textsuperscript{454} \textit{Ibid.}
\item \textsuperscript{455} Averbug, A. ‘Mercosul: Economic Trends and Outlook’; \url{www.finame.gov.br/english/studies/rev101.pdf}, p6
\item \textsuperscript{456} Appendix 26 (UKTI), para 4
\end{itemize}
remained largely untouched”.457 It called for further improvements and harmonized customs rules throughout Mercosur countries,458 as well as seeing benefits in harmonisation across the bloc of anti-dumping regulations, which “as well as a uniform competition policy, would also benefit Mercosur by enhancing regional integration”.459 The CBI had heard reports of additional duties being levied beyond standard import tariffs, with levels varying by country.460

**Internal asymmetries**

185. Because of the asymmetries between the two smaller counties in Mercosur and Brazil and Argentina (and now Venezuela), Uruguay and Paraguay continue to argue for special treatment within the bloc. In 2004 Mercosur members talked about establishing a structural convergence fund to help the bloc’s smaller members.461 However, progress has been slow, and Uruguay and Paraguay continue to be dissatisfied with their access to Argentine and Brazilian markets. Uruguay has rising trade deficits with Mercosur countries.462 A 2004 *Economist* article called Mercosur “an odd quartet” and drew some comparisons with the EU:

> “Brazil dwarfs its three partners, but is not rich enough to subsidise them nor willing to surrender chunks of sovereignty, as Germany has done to promote European union. Argentina is too small to play the strong sponsoring role of France, and sometimes adopts the wariness of Britain. All four members are prone to economic crises, which they spread to each other, triggering every-country-for-itself reactions. The new generation of leaders may make matters worse. Keen as they are on Mercosur, they are even more eager to expand the state’s role in development, which is hard to reconcile with freer trade and uniform rules.”

UKTI told us that it was “quite clear that Argentina and Brazil do not take seriously the economic needs of their smaller neighbours, who entirely lack the political or economic clout to impose them.”464

186. Uruguay in particular has been actively considering negotiating a bilateral free trade agreement (FTA) with the US, which, without the involvement of its Mercosur partners, would violate the Mercosur common external tariff and so undermine the customs union, and potentially lead to its withdrawal from the bloc,465 or its becoming an associate member like Chile. In something of a compromise Uruguay reached a Trade and
Investment Framework Agreement (TIFA) with the US in January 2007. This is in some ways similar to the UK-Brazil JETCO, but has been seen by commentators as a stepping stone to a full FTA, with signs since that Uruguay may yet intend to pursue this course. It has recently been reported that the Brazilian Minister of Development, Industry and Foreign Trade has said that although Brazil would not consider a bilateral FTA with the US, a Mercosur—US FTA could be considered.

187. The issue has prompted expressions from the bloc’s larger members of greater support for its smaller members. There have been proposals for a development fund, to which Brazil would contribute the lion’s share, and at the January 2007 Rio summit Brazil’s President Lula da Silva said that national interests would need to be put aside to tackle inequalities within Mercosur, and specifically that Brazil and Argentina should look beyond their own interests for the sake of the bloc. While no specific actions were taken at the time, in February 2007 Brazilian and Uruguayan ministers reached five bilateral deals on promoting trade and investment, cooperation over developing bio-fuels, and a new permanent commission on energy and mining.

**A ‘South American Community of Nations’?**

188. The proposed Free Trade Area of the Americas has foundered amid opposition from Mercosur countries and Venezuela in particular. However, there have been attempts to amalgamate Mercosur and the Andean Community, South America’s two blocs, into a single Community of Nations. The members of both blocs, along with Chile and Caribbean Community members Surinam and Guyana, committed themselves to advancing this in December 2004. However, little progress has been made, with former Andean Community members Venezuela and Bolivia looking to Mercosur membership. The second CSN summit was held in Cochabamba, Bolivia in December 2006, and agreed to set up a group to study the possibility of a continent-wide union and a South American parliament.

**EU-Mercosur relations**

189. Mercosur signed its first free trade agreement with Chile in June 1996, and has since reached free trade agreements covering most of South America. It is also nearing an
inter-regional free trade agreement with the Gulf Co-operative Council countries (Saudi Arabia, Bahrain, Qatar, the United Arab Emirates, Kuwait and Oman) which is expected to cover goods, services and investment.\textsuperscript{473}

190. The EU is Mercosur’s largest partner for trade and investment, taking a third of Mercosur trade, compared with a quarter taken by the US,\textsuperscript{474} while Mercosur is the EU’s 9\textsuperscript{th} largest trade partner, with over half of exports to the EU being agricultural products. Since November 1999 the EU and Mercosur have been negotiating an inter-regional Association Agreement on a bloc to bloc basis. The trade talks include liberalisation of trade in goods and services; improved access to government procurement; a better investment climate; IPR protection; co-operation on competition policy; agreements on sanitary and phytosanitary measures, wines and spirits, trade defence instruments disciplines, and a Business Facilitation Action Plan; and a binding dispute settlement system.\textsuperscript{475} While the political and co-operation parts were nearly concluded, difficulties on the trade chapters caused the talks to be suspended in October 2004.\textsuperscript{476} A September 2005 ministerial meeting saw no progress, and both sides agreed to focus on multilateral Doha Round trade talks at the WTO. Sporadic technical meetings continue, including a meeting in Rio in November 2006.\textsuperscript{477}

191. The European Commission’s new trade strategy outlined in October 2006 specifically proposed the reinvigoration of EU-Mercosur negotiations, alongside completing negotiations with the Gulf Co-operative Council (GCC) countries, and more controversially the opening of new negotiations with ASEAN, South Korea and India. Among these, completing talks with Mercosur and initiating talks with ASEAN and South Korea were priorities.

192. In April 2007, the Council of Ministers agreed negotiating mandates for the European Commission for the new free trade talks with India, ASEAN and South Korea, with negotiations expected to start within months.\textsuperscript{478} The same meeting of the General Affairs and External Relations Council also agreed Commission mandates for talks both with the Central American countries and with the Andean Community—with which the EU is the second largest trade partner—\textsuperscript{479}—with a view to concluding association agreements incorporating a free trade agreement, similar to the prospective arrangement with Mercosur.\textsuperscript{480} The bilateral and regional approach is regarded with scepticism by some, as undermining the multilateral rules-based WTO system, or at least as a second-best to a

\textsuperscript{473} ‘Mercosur-GCC agreement ‘close’, International Trade Center World Trade Net Business Briefing 8:2(1), February 2007. Partial scope agreements have been reached with other developing countries, including India and South Africa.

\textsuperscript{474} Appendix 14 (European Commission)

\textsuperscript{475} Appendix 26 (UKTI), para 16

\textsuperscript{476} Appendix 23 (UKTI), annex B

\textsuperscript{477} Appendix 14 (European Commission)

\textsuperscript{478} ‘EU to start FTA negotiations with India, Korea, ASEAN’, ICTSD BRIDGES Weekly 11:14, 25 April 2007

\textsuperscript{479} Appendix 14 (European Commission)

multilateral trade deal, although the Council conclusions emphasised the importance of the Doha Round and the WTO-compatibility of the proposed new agreements.\(^{481}\) However, it is beyond the scope of this inquiry to examine this issue in greater detail.

193. Any EU-Mercosur agreement is likely to be similar to those already reached between the EU and South Africa, Chile and Mexico. The trade relationship would be asymmetric in favour of Mercosur, within WTO rules on trade agreements. In the meantime, exports from all Mercosur countries are eligible for preferential access to the EU market through its Generalised System of Preferences, although in some cases, such as Brazil, exports of some products to the EU are not eligible if they have been ‘graduated’ from the preference system.\(^{482}\) The real income gains from a full FTA with Mercosur—not including Venezuela—have been estimated at 2% of GDP for Mercosur and 0.1% of GDP for the pre-2007 enlargement EU25,\(^{483}\) with these income gains coming mostly from tariff reductions and also from trade facilitation.\(^{484}\) A 2004 Mercosur—EU Business Forum simulation suggested that the cost of no agreement would be $3.7 billion a year for goods trade, or $5 billion a year with services and investment included.\(^{485}\)

194. UKTI said that an inter-regional agreement would be “unlikely to deliver the same level of economic benefits [to the UK] as an FTA with another country or regional bloc due to the relatively low level of UK trade with the region”, noting that other EU countries with greater exports were likely to benefit more.\(^{486}\) However, it said that importers were “likely to benefit greatly, particularly the food and drink manufacturing industry, which would benefit from a reduction of the high tariffs applied by the EU to agricultural and food product exports from Mercosur”, noting that EU tariffs for these goods ranged from 19% to 75%, and that, given that the UK is the fifth largest food and drink exporter, this had the potential to “boost the UK’s export performance in other markets […] as well as supporting the manufacturing sector”.\(^{487}\) The CBI generally agreed with the recommendations of the Mercosur—EU Business Forum that an agreement should address “non-tariff barriers and trade facilitation issues, balanced rules of origin and tariff liberalisation for the bulk of trade within ten years.”\(^{488}\) The CBI stated that UK businesses had an interest in lowering the price of imports of commodities from Brazil through lower EU agricultural tariffs,\(^{489}\) although, having received no evidence from UK agricultural interests on this point, we cannot reach a definitive conclusion on the balance of advantage.

---

481 Ibid.
483 Appendix 14 (European Commission), citing the EU’s preliminary Sustainability Impact Assessment
484 University of Manchester, SIA of Mercosur Negotiations – Mid Term Report (Consultation Draft), 21 November 2006, page vi
485 Appendices 14 (European Commission) & 10 (CBI), para A20
486 Appendix 26 (UKTI)
487 Ibid.
488 Appendix 11 (CBI)
489 Appendix 10 (CBI), paras 14 and 15
The CBI also noted that the EU was seeking to guarantee free movement of its goods within the Mercosur bloc.490

195. As part of the new trade strategy, the European Commission outlined its new market access strategy in April 2006 which proposes “market access teams” in key markets “to spot potential barriers before they appear and to tackle existing obstacles to trade”, including non-tariff barriers and problems over intellectual property rights. Although not explicit, the focus is thought to be on China, Russia and India, but reportedly Brazil is also to feature, along with Norway, Switzerland and the US.491

The importance of the Doha Round

196. We previously examined the EU’s negotiating position for the Hong Kong WTO ministerial meeting in December 2005, and this Report gives us an opportunity to examine progress in the multilateral Doha Round, formally the Doha Development Agenda (DDA). The Round covers a broad range of issues, but in terms of trade with the Mercosur countries the EU’s aims are for Brazilian and Argentine tariffs on industrial products to be lowered, further and deeper liberalisation of trade in services, and advances in trade facilitation and customs processes, as well as building a more solid framework for regional trade agreements, of which EU—Mercosur would be one example.

197. The European Commission told us that the slow progress in the Mercosur talks was in part due to challenges facing the bloc and “parallelism” with the Doha Round.492 The regional talks were suspended pending an outcome to the Doha Round “since it was envisaged that any Free Trade Agreement would have to reflect the final deal and liberalise further.”493 There appears to be general agreement among witnesses that a deal in the WTO should be the overwhelming priority,494 even the “jewel in the crown”495 according to the CBI, with acceptance that the EU—Mercosur talks are unlikely to see “significant advances” while the Doha Round remains unresolved.496 UKTI also said: “We now await the outcome of the DDA before it is possible to make any further substantive progress.”497

198. Agriculture is the key to both sets of negotiations. The Doha Round is an important way of addressing concerns over agriculture, especially as regards subsidies. The CBI suggested that as “some of the most gritty issues within an EU—Mercosur negotiation”, including agricultural subsidies for example, could not be resolved multilaterally, “it is unlikely that they will be solved at a regional or bilateral level.”498 It said that the two sets of

490 Appendix 10 (CBI)
491 ‘Mandelson to launch EU drive against trade barriers’, Financial Times, 18 April 2007
492 Appendix 14 (European Commission)
493 Appendix 10 (CBI), paras 14 and 15
494 Trade Minister (Q154), European Commission (Appendix 14) and CBI (Appendix 10, para 4)
495 Q 128
496 EU Trade Commissioner Peter Mandelson speaking in December 2006 (ITC-World Trade Net Business Briefing, 8:1(1), January 2007)
497 Appendix 23 (UKTI), annex B
498 Q 147
talks were “intimately tied”, and that the EU had been “unwilling to offer Mercosur greater market access until the DDA level of liberalisation has been ascertained.”

199. In Doha it is broadly recognised that the ‘advanced’ developing countries—Brazil and India in particular, but to an extent countries such as Argentina—would be willing to liberalise trade in industrial products and services subject to concessions on agricultural tariffs and subsidies from the EU and the US. UKTI told us that Brazil was “probably one of the more willing to be flexible if the right deal on agriculture is on the table.”

200. Brazil has an important role to play in completing the Doha Round. It is a potential beneficiary of a successful outcome due to its comparative advantage in agriculture. As the Trade Minister noted, Brazil has the “crucial” leadership and spokesperson role of the G20 group of developing countries at the WTO, which also includes fellow Mercosur members Argentina, Paraguay, Uruguay and Venezuela, as well as India and China. Brazil is also part of the G4, or ‘New Quad’, alongside the EU, the US and India, and the G6—the G4 plus Japan and Australia—which are both important in attempts to resolve the key issues in the Doha Round. Brazil has said that it will be the first non-developed country to grant exports from the group of 32 Least Developed Countries in the WTO duty- and quota-free market access, expected in the first half of 2007. However, Brazil and the G20 will not resolve the Doha Round alone, which requires concessions from all parties, including the US, the EU and other WTO groupings of which Brazil is not a part. The latter include the G33 (though this does include G20 members China, India and Venezuela), and the G90, which is made up of the African, Caribbean and Pacific Group (ACP), the African Union, and the Least-Developed Countries (LDC) group.

201. The WTO rules on regional trade agreements (RTAs) are part of the DDA, and a successful conclusion is likely to bring greater clarity as to what is permissible and potentially to include specific ‘special and differential treatment’ for developing countries, such as longer transition periods or reduced product coverage, in so-called ‘North-South’ trade agreements of which EU-Mercosur would be an example. While the CBI saw “pros and cons” of RTAs, they said that “when we look at a market like Mercosur we can see advantages so long as the negotiations build on the WTO process, complement that liberalisation and, in particular, expand into areas such as enforcement of intellectual property rights where the WTO is not currently involved.”

202. We are broadly supportive of an EU-Mercosur agreement, which should be consistent with trade rules and beneficial to both parties, and which unlike the Doha Round offers an opportunity to address the many non-tariff barriers to trade and to liberalise services further, both of which are important for UK businesses. We note the proposals within the new Commission trade strategy to pursue trade agreements with a

499 Appendix 11 (CBI), para 20
500 Appendix 23 (UKTI), para 3.2
501 Q 151
502 ‘Brazil to grant duty- and quota-free market access to LDC exports’, ICTSD BRIDGES Weekly 10:41, 6 December 2006
503 Q 148
number of partners, including some that we have previously carried out inquiries on: India and ASEAN. It is important that the existing and proposed EU negotiations should not in any way detract from Doha, but seek to build on a successful multilateral outcome which should include strengthening the WTO rules on preferential regional trade agreements.

203. However, there remains considerable uncertainty regarding the fate of the Doha Round. The US presidential fast-track negotiating authority—important for the US to remain a credible negotiator in the WTO talks—has effectively expired, and there is continuing uncertainty over whether Congress will renew it in the immediate future. Ultimately, should the opportunity of Doha be lost, our major trading partners are likely to pursue regional and bilateral preferential trade agreements with renewed vigour, which would encourage the EU to accelerate its regional and bilateral initiatives. If Doha fails, then completion of the EU-Mercosur talks, and bilateral initiatives such as the JETCOs set up between the UK and Brazil, India and China are likely to take on even greater significance. As the Trade Minister noted: “The service sector is one of the areas where I believe we can make major gains for the UK, but the problem that remains is the removal of barriers, whether or not we have Doha.” 504

504 Q 179
Conclusions and recommendations

Why is the UK lagging behind its competitors?

1. As UK Trade and Investment said: “Compared to the media attention given to other rapidly developing economies such as China and India, Brazil suffers from outdated stereotyping and poor knowledge. UKTI and other agencies could help importantly to fill this knowledge gap.” We agree. Lack of knowledge and outdated perceptions among UK businesses appear to us to be the main reasons underlying the lack of UK engagement with Brazil compared with our competitors. We have seen many examples of opportunities in Brazil and the rest of Mercosur that could be exploited, and indeed are being exploited by competitors. We hope that by raising awareness of both the opportunities and risks involved in these markets, this Report and its supporting evidence will make a useful contribution to those companies who are considering trading with or investing in Brazil, Argentina and the other Mercosur countries. (Paragraph 29 and 41)

Opportunities for business in Brazil

2. We generally agree with the selection of the seven priority sectors (agriculture, engineering, environment, healthcare and life sciences, oil and gas, sports and leisure infrastructure, and chemicals) and six opportunity sectors selected by UKTI for 2007/08. However, given Brazil's BRIC status it is perhaps surprising that only one sector—oil and gas—is considered a global priority. It is also unclear why two out of the three strategic sectors identified bilaterally as part of the Joint Economic and Trade Committee (JETCO) process during 2006/07—aerospace and financial services—are only UKTI opportunity sectors for Brazil in 2007/08. It is imperative that there is consistency between the priorities of JETCO and UKTI. We also hope that the UKTI sector strategies currently under development (covering ICT, life sciences, creative industries and energy) will reflect the due importance of Brazil alongside the other BRICs, particularly China and India. (Paragraph 49 and 99)

3. While we welcome the setting up by UKTI of the Financial Services Sector Advisory Board (FSSAB) because of the importance of financial services to the UK economy, we note that the UKTI financial sector strategy mentions Brazil only in passing, and that country strategies are planned for China, India, Russia and the Gulf, but not Brazil. We believe the scale of opportunities for financial services available in Brazil should be recognised by placing the market on a par with China, India and the Gulf, or at least above other emerging markets. As UKTI is developing dedicated China and India financial strategies, with Russia to follow this year, a dedicated strategy for Brazil should be seriously considered. (Paragraph 109)

4. We also hope that these developments and the Lord Mayor’s planned visit to Brazil later this year will help encourage the London Stock Exchange to establish a permanent presence in Brazil, as ThinkLondon, London’s inward investment agency have in partnership with UKTI. This would have the potential to serve as a base for the whole of South America and increase competition with the New York Stock
Exchange. ThinkLondon also recently reached the first bilateral investment promotion agreement between a Chinese and a European city, and we believe there is scope for a similar initiative with São Paulo, for example. (Paragraph 110)

5. In science, as we have discovered in other areas, Brazil receives less attention than China and India. We hope that the Year of Science will ensure due weight is given to Brazil’s strengths in life sciences in particular, and to the possibilities for mutually beneficial co-operation between Brazil and the UK. We fully support the Year of Science with Brazil, and hope that it will not only contribute to a better understanding of the potential of Brazil in science, but also result in a positive spill-over effect into the general UK-Brazil trade and investment relationship. (Paragraph 138)

6. We welcome the commitment of the UK and Brazil to a bio-ethanol partnership with South Africa, which was reinforced by expressions of support for renewable energy trade and investment partnerships generally, and particularly in ethanol, in the UK-Brazil JETCO recommendations. In doing so we note that criticism is frequently made of Brazil’s bio-ethanol production, including the threat posed to the rainforest. However, all large-scale agriculture has biodiversity implications, and while the rainforest is clearly vitally important, we have been assured that the areas most suitable for sugarcane production are not rainforest areas. (Paragraph 136)

7. We note the unfortunate limitations for UK businesses caused by the Brazilian Government’s local content rules for present and future Embraer models, and that the UK remains disadvantaged against competitors with an established local presence. We welcome the selection of Aerospace as a JETCO strategic sector, and hope that the proposed JETCO working group on aerospace will be successful in reducing the barriers. (Paragraph 103)

8. Brazil is unlikely to be a market that presents immediate or easy wins for SMEs, and we therefore agree that medium-sized and large companies should be the focus of UKTI support for this market. However, the experience of our EU competitors shows that it is possible to open up opportunities for smaller companies as part of the supply chain for larger companies breaking into the Brazil market. We would welcome more emphasis on this area in UKTI’s work. Moreover, where niche companies are looking to trade with Brazil or opportunities for smaller companies present themselves, UKTI should provide them with the necessary support and information. (Paragraph 46)

**Barriers to trade with Brazil**

9. While language is clearly a barrier, the language problem is not unique to Brazil: foreign businesses in China also need to employ Chinese speakers. The damaging presumption, still too widespread in the British business and political culture, that English is the universal language of trade and the only necessary linguistic tool when doing business abroad, is harming our commercial prospects in Brazil just as it is in many other markets around the world. (Paragraph 57)
10. Tariff and customs barriers do impede trade with Brazil. However, though tariff and customs barriers cause annoyance to potential importers and may provide opportunities for corruption, the situation is no worse—and in some cases less serious—in Brazil than in other developing countries. It is important, though, that this issue is addressed in the JETCO process. (Paragraph 61)

11. UKTI said that while local partners were not a requirement, “if you have got a local partner it is a lot easier to get through the mass of regulation. […] it is imperative for British companies that want to really establish themselves in the market to have some local knowledge.” We note the strong positioning of UKTI to help UK businesses identify such partners. (Paragraph 69)

12. Brazil’s failures in intellectual property rights protection lie in the area of enforcement, not legislation. The UK has a good record in enforcement and could provide useful training and advice. Without advances in enforcement, Brazil may well not receive the investment it needs to develop high-tech and science R&D, from either the UK or elsewhere. (Paragraph 89)

13. Because of the constitutional and political issues that lie behind the non-ratification of Brazil’s bilateral investment agreements an Investment Protection and Promotion Agreement between the UK and Brazil is unlikely in the near future. It was perhaps over-ambitious to include such a difficult issue in the JETCO priorities, but it nevertheless remains an important goal for UK business, and we urge the Government to do all it can to ensure that progress is made. (Paragraph 92)

14. A number of our witnesses were very concerned about the lack of a double taxation agreement between the UK and Brazil. We were also told of UK businesses that had invested via Italy in order to benefit from the better tax situation. We find it difficult to believe, therefore, that this is having no effect on statistics regarding UK investment in Brazil. It seems there is a certain amount of intransigence on both sides. We therefore urge the Government to re-examine this matter which seems likely to be putting us at a disadvantage vis à vis our competitors, and remains a key priority of UK businesses. If the re-examination demonstrates the significance we anticipate, then such a treaty must become a key objective of the JETCO process. (Paragraphs 34 and 96)

15. We recognise that a number of real, if surmountable, barriers exist to trade with and investment in Brazil, but given that these generally face our competitors as well, we find these insufficient to explain the relatively poor performance of the UK. Other than the problems we have outlined, witnesses did not pinpoint any other factors that would explain this situation. We are therefore led to conclude that awareness and perception issues are the greatest barriers to trading with Brazil. We hope that this Report will help to make British business more aware of the opportunities afforded by, and give indications of how companies can tackle some of the difficulties involved in doing business with, Brazil. (Paragraph 82)
Tackling the barriers

16. We support the creation and work of the UK-Brazil JETCO, but note that its success will depend on maintaining both political and business interest and involvement in both countries. We are pleased to see that events are being planned which will serve to raise awareness of the available opportunities, but while we recognise it is still early in the life of the JETCO with Brazil, progress over the six months since the Ministerial meeting has been limited. Certainly the planning work so far needs to be converted into genuine action: we believe that it is essential that momentum is maintained to ensure the continued support of business and to maximise JETCO’s awareness-raising potential. (Paragraph 87)

17. We welcome the positive contribution of the new UKTI strategy on resources committed to the Brazilian market. We note, however, that these resources have only partially reversed the decline seen after the 2004 Spending Review and the closure of UKTI’s regional offices in Brazil, and that these remain more than 10% below the level seen in 2003/04. We acknowledge, but do not fully share, the CBI’s view that, for UKTI generally “an excessive concentration of resources on China and India could lead to missed opportunities elsewhere”. (Paragraph 44 and 45)

18. We have previously raised concerns about unhelpful competition between the English Regional Development Agencies, and the vital need for co-operation between UKTI and them. We were therefore relieved to hear that these bodies do not have permanent on-the-ground presence in Brazil, and there is little sign of damaging competition between them in their Brazil-related activities. (Paragraph 52)

Brazil v. the rest of Mercosur

19. We also note the view expressed by British Expertise that the greatest opportunities may not be in Brazil but in the smaller countries in the region. UKTI must ensure that while focusing on key emerging markets like Brazil it does not miss out on opportunities available from smaller markets in Mercosur and Latin America more generally and ensure that it transmits these opportunities to UK businesses. (Paragraph 177)

Argentina

20. UKTI told us that in the longer term Argentina’s economic recovery would require structural reforms: “combating tax evasion, excessive bureaucracy, corruption and an inefficient judiciary system will be essential to improve Argentine competitiveness. Improvements in legal and judicial security are needed to attract, and maintain, foreign investment.” We agree. (Paragraph 155)

21. The British Argentine Chamber of Commerce informed us that UKTI financial support for outward missions to Argentina had been withdrawn in 2005 after changes in government support for export promotion. We believe that this decision should be reconsidered in the light of Argentina’s future potential. The BACC also say that they would “welcome the opportunity of working closer with UKTI and
having better communication in order to help British companies understand and identify opportunities in Argentina”. We support this suggestion. (Paragraph 157)

22. The Argentine Government’s so-called price “agreements” with businesses—tantamount to price controls—were the subject of widespread complaint during our visit. Unconventional means appear to have been used to enforce these controls, for example UKTI told us that President Kirchner “encouraged a blockade against Shell in February 2005 after the company decided to raise petrol prices.” We were surprised to hear that the Trade Minister was not aware of the problems relating to price controls in Argentina, as in their evidence to us UKTI had cited Argentine government intervention, including price control, as an example of an internal barrier to trade faced by UK companies. These price controls risk deterring UK investment in Argentina. (Paragraph 152)

Uruguay

23. We are concerned that the UKTI service for Uruguay will share the fate of that for Paraguay, which no longer has a UKTI presence and for which very limited information was available for this inquiry. This move seems perverse, given the strong historic ties of friendship between the UK and Uruguay, the country’s benign business environment, that UK companies are choosing to invest in Uruguay as a base from which to access other South American countries, the high level of inquiries received relating to Uruguay and that the institutions of Mercosur are based in Montevideo. We are unconvinced that it will prove possible to provide sufficient quality of cover from other neighbouring posts and we therefore urge UKTI to reverse its decision to remove its commercial presence from Uruguay. (Paragraph 165)

Paraguay

24. Although we accept that limits on its resources mean that UKTI must make choices between markets globally, we believe that while Paraguay may not merit a full service there should at a bare minimum be basic market and sectoral information available through the UKTI website, particularly when information is available on the website of one of its parent departments. (Paragraph 166)

Regional free trade agreements v. the Doha Round

25. Mercosur is widely thought to be modelled on the European Union, yet although some see it as an embryonic ‘EU in South America’ its level of integration falls some way short of that of the EU. Even within the Mercosur countries themselves, we noted that there was a considerable degree of scepticism about the future of the organisation. Mercosur faces significant challenges as its development has been hindered by national interests, internal asymmetries, and disputes between members which have even been taken to the WTO. The Argentine and Brazilian economic crises, subsequent devaluations and trade disputes have been politically problematic for Mercosur. (Paragraph 178)
26. We are broadly supportive of an EU-Mercosur agreement, which should be consistent with trade rules and beneficial to both parties, and which unlike the Doha Round offers an opportunity to address the many non-tariff barriers to trade and to liberalise services further, both of which are important for UK businesses. We note the proposals within the new European Commission trade strategy to pursue trade agreements with a number of partners, including some that we have previously carried out inquiries on: India and ASEAN. It is important that the existing and proposed EU negotiations should not in any way detract from Doha, but seek to build on a successful multilateral outcome which should include strengthening the WTO rules on preferential regional trade agreements. (Paragraph 202)

27. However, there remains considerable uncertainty regarding the fate of the Doha Round. Ultimately, should the opportunity of Doha be lost, our major trading partners are likely to pursue regional and bilateral preferential trade agreements with renewed vigour, which would encourage the EU to accelerate its regional and bilateral initiatives. If Doha fails, then completion of the EU-Mercosur talks, and bilateral initiatives such as the JETCOs set up between the UK and Brazil, India and China are likely to take on even greater significance. As the Trade Minister noted: “The service sector is one of the areas where I believe we can make major gains for the UK, but the problem that remains is the removal of barriers, whether or not we have Doha.” (Paragraph 203)
Formal minutes

Tuesday 22 May 2007

Members present:

Mr Peter Luff, in the Chair

Roger Berry  Miss Julie Kirkbride
Mr Brian Binley  Judy Mallaber
Mrs Claire Curtis-Thomas  Mr Mike Weir
Mr Mark Hunter  Mr Anthony Wright

Draft Report (Trade with Brazil and Mercosur), proposed by the Chairman, brought up and read.

Ordered, That the Chairman’s draft Report be read a second time, paragraph by paragraph.

Paragraphs 1-203 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Sixth Report of the Committee to the House.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

[Adjourned till Tuesday 5 June at 10.00am]
# List of witnesses

**Tuesday 7 November 2006**

Mr Ken Timmins, Mr. Adrian Hockney, and Mr. Paul Blackmore, **UK Trade & Investment**  
Page Ev 1

**Tuesday 9 January 2007**

Mr. Gary Campkin, Mr. Nick Miller, and Mr. Richard White, **Confederation of British Industry**  
Page Ev 13

**Tuesday 20 February**

Rt Hon Ian McCartney, Minister of State for Trade Investment and Foreign Affairs, and Mr. John Souttar, **Department of Trade and Industry**, and Mr. Adrian Hockney, **UK Trade & Investment**  
Page Ev 23

**Tuesday 20 February**

Professor Sir David King, **Office of Science and Innovation**  
Page Ev 40
## List of written evidence

<table>
<thead>
<tr>
<th>Number</th>
<th>Organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Anglo American plc</td>
</tr>
<tr>
<td>2</td>
<td>Argentine Ambassador</td>
</tr>
<tr>
<td>3</td>
<td>Argentine Ambassador (Supplementary)</td>
</tr>
<tr>
<td>4</td>
<td>Brazilian Embassy</td>
</tr>
<tr>
<td>5</td>
<td>British Argentine Chamber of Commerce</td>
</tr>
<tr>
<td>6</td>
<td>British Chamber of Commerce in Brazil</td>
</tr>
<tr>
<td>7</td>
<td>British Expertise</td>
</tr>
<tr>
<td>8</td>
<td>British Telecom</td>
</tr>
<tr>
<td>9</td>
<td>Clifford Chance</td>
</tr>
<tr>
<td>10</td>
<td>Confederation of British Industry</td>
</tr>
<tr>
<td>11</td>
<td>Confederation of British Industry (Supplementary)</td>
</tr>
<tr>
<td>12</td>
<td>Corporation of London</td>
</tr>
<tr>
<td>13</td>
<td>Corporation of London (Supplementary)</td>
</tr>
<tr>
<td>14</td>
<td>European Commission</td>
</tr>
<tr>
<td>15</td>
<td>Linpac Plastics</td>
</tr>
<tr>
<td>16</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>17</td>
<td>Office of Science and Innovation</td>
</tr>
<tr>
<td>18</td>
<td>Office of Science and Innovation (Supplementary)</td>
</tr>
<tr>
<td>19</td>
<td>Paul Eadie MBE</td>
</tr>
<tr>
<td>20</td>
<td>Rio Tinto</td>
</tr>
<tr>
<td>21</td>
<td>Society of British Aerospace Companies</td>
</tr>
<tr>
<td>22</td>
<td>Think London</td>
</tr>
<tr>
<td>23</td>
<td>UK Trade &amp; Investment</td>
</tr>
<tr>
<td>24</td>
<td>UK Trade &amp; Investment (Supplementary)</td>
</tr>
<tr>
<td>25</td>
<td>UK Trade &amp; Investment (Supplementary)</td>
</tr>
<tr>
<td>26</td>
<td>UK Trade &amp; Investment (Supplementary)</td>
</tr>
<tr>
<td>27</td>
<td>UK Trade &amp; Investment (Supplementary)</td>
</tr>
<tr>
<td>28</td>
<td>UK Trade &amp; Investment (Supplementary)</td>
</tr>
<tr>
<td>29</td>
<td>University of Birmingham</td>
</tr>
</tbody>
</table>
List of unprinted written evidence

Additional papers have been received from the following and have been reported to the House but to save printing costs they have not been printed and copies have been placed in the House of Commons Library where they may be inspected by members. Other copies are in the Parliamentary Archives, House of Lords and are available to the public for inspection. Requests for inspection should be addressed to the Parliamentary Archives, House of Lords, London SW1. (Tel 020 7219 3074) hours of inspection are from 9:30am to 5:00pm on Mondays to Fridays.

Orange
UK Embassy in Argentina
Vodaphone