

Trading Overseas

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OPENING THE AMERICAN MARKET – WITH OR WITHOUT THE FTAA

The negotiations to construct the FTAA – Free Trade Area of the Americas – especially between Mercosur and the United States - are at an impasse, according to Lia Valls Pereira. She is a professor of International Economics at Universidade do Estado do Rio de Janeiro (UERJ) and a researcher at the Brazilian Institute of Economics (IBRE) at Fundação Getúlio Vargas (FGV). She explains that the initial format for the FTAA, which agreed to establish group negotiations with the thirty-four countries and have an agenda with common interests, no longer exists.

At first, the FTAA agenda included negotiations to market access, agriculture (market access and subsidies), services, investment, intellectual property rights, government procurement, antidumping and countervailing duties, competition policy and dispute settlement. “The agreement foresaw a negotiation based on the principle of single undertaking, which means, the final draft should contain the agreement reached in all negotiation topics”, the economist states. “In 2002, a preparatory draft of the FTAA Agreement, with regards to all negotiation topics, was written. However, the text was full of brackets, which means the lack of an agreement. It led to discontent of the participating countries”, she explains.

At the end of 2003, Mercosur proposed a change in the negotiating structure. It optioned to negotiate market access with the United States bilaterally and decided to let more sensible issues, such as intellectual property rights and environment, be held at the World Trade Organization (WTO). “At first, the proposition was accepted but it did not go far, as the United States was already negotiating the FTAA broad agenda with Central American countries, Chile and Mexico. All the countries that agreed to this type of group negotiation questioned the proposition of bilateral agreements with different agendas”, she explains.

The possibility of negotiating a broad agenda with South American countries made the United States step back. According to Lia Valls, the lack of offers in regulatory topics, such as investment and intellectual property rights, led to the menace of less offers to market access. “Besides, having Mercosur as the last bilateral agreement to be reached may be an American strategy to impose the topics that interest North Americans, such as credit access, for instance”, she evaluates.

All in all, according to the professor, the game of commercial negotiations requires diplomatic strategies. “The impasses are part of the process, the political issue may permeate the negotiations, but, in the end, what really interests is the evaluation of economic costs and benefits in these agreements”, she concludes.

POSSIBILITIES

As Brazil and the United States signal a restart to the commercial negotiations between Mercosur and the latter, President Lula’s challenge is to define the priorities and conciliate the agendas, both bilaterally and at the WTO, according to the economist. “Negotiations do take time and every country intends to defend its territory, however, it is necessary to have political ability to negotiate before all other bilateral agreements are reached, which would make Mercosur accept the same type of deals”, she alerts.

Recently, the American President George W. Bush announced cuts in the budget for the fiscal year 2006. Agriculture is among the affected sectors, having fewer subsidies. According to the economist, this measure from the American President may help negotiate the liberalization of the agricultural foreign market at WTO. “If the American government defends less State interference in the sector, this point of view may be a convincing argument in favor of Mercosur, which defends the end of agricultural subsidies to help the entrance of South-American goods”, she analyses. Lia Valls Pereira reminds that Brazil has already won one round of negotiations at the WTO, where the subsidies to the American cotton were dismantled.

EFFORTS

The researcher reminds that the fight for market liberalization is a constant practice in the globalized world; however, she alerts that only the opening of the markets is not enough for Brazil to grow. “Exporting may be a good deal if Brazil is organized domestically. If the credit offer is not enough, as well as infrastructure, and if the interest rate is not low, there will not be a large economic growth”, she concludes.

The professor also evaluates the participation of President Lula’s government in this effort to open markets. According to her, it is concerned not only about negotiating but also about finding a marketing strategy to sell Brazilian goods abroad. “I point out the Colombian government initiative, which advertised a coffee brand in several countries with strong economy, such as the United States, having the product sold and searched abroad”, she reminds.

SMALL AND MID-SIZED COMPANIES

The economist remarks it is difficult for the companies, especially the small and mid-sized companies, to get established in both domestic and foreign markets. According to Lia Valls Pereira, the government must pay attention to potential exporting companies, identify the opportunities and support them, whether with market strategies or technical support”, she analyses.

According to the economist, supporting small and mid-sized companies would be a good deal for the country, as it is one of the sectors that requires a larger number of employments. “But it is also necessary to have a well-planned strategy so as not to have the companies start exporting and quit in the first year, as it usually happens. As this business involves risk management, it must be carefully studied and well-planned, so that the investment will not be lost and the companies will not be frustrated”, she concludes.

Real Case

From Lack of Planning to Losses

By Paula Muniz

International Consultant at Westchester International Corp.

A successful Brazilian company that sells feminine clothing starts selling to the United States, focusing on New York City as its potential market. The company closes a deal with a New Yorker showroom, where it established a fixed value per month and a remarkable commission on sales, as well as an agreement of exclusivity. The sales started through the showroom and New York fair and the exporting is conducted by a Trading Company, which is an importing vehicle in the United States.

As sales grow, problems begin to arise, such as: lack of formality in the clients' demands, merchandising refund, delay in the delivery of goods, and lack of payment guarantees. It generates discontent towards the showroom, as it was not concerned about refunds and payments, and it did not permit direct contact with the final clients and it did not provide the necessary information, when demanded.

In spite of the product's acceptance, the company noticed that lack of planning and an inefficient infrastructure in the United States made it difficult for the product to enter the market. It also learned how the market behaves with regards to quality, delivery dates, ways of payment and credit.

The situation became worse when the company verified the losses, as a consequence of these problems. The business lost around 63% of all the merchandising sold. Thus, the company feels it needs a broader presence in the United States, as well as to make its clients more accessible.

When facing chaos, the company decided to hire an Exporting Management Company in Brazil. With broad experience in the area and large structure abroad, the management company starts helping the clothing company to continue its sales in a structured way, so as to achieve its dreamed success in the international market.

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The small and mid-sized companies and the export credit system in Brazil

* Luis Henrique Perligero

In any country, the credit or financing system is fundamental for the export promotion policy. In Brazil, despite the efforts from the public system to enlarge the mechanisms to support the exports, the amount of the official credit lines of this kind could not supply the exporters' demand in 2003 – the last year that serves as reference for the analysis. Out of the US\$73,1 billion exported by the country, only 6.3%, or us\$4,6 billion, were supported by the official lines: BNDES (Pre-Shipment, Special Pre-Shipment and Post-Shipment), Proex-Financiamento (Export Financing Program – Financing) and Proex-Equalização (Export Financing Program – Equalization). In 2004, despite being altered, the same relations were kept, as shown below.

The private mechanisms (ACC + ACE + Pre-Payments) have reached the amount of US\$41,1 billion, or 56% of the financial amount exported in 2003. However, these mechanisms are subjected, in terms of price, term and amount, to the supply variations linked to the international banks strategies, which provide funding to these lines, in relation to Brazil. In these mechanisms, the component Brazil-risk influences the variations in the term extension, resource allocation and interest rate.

In 2003, out of the 17,743 exporting companies, only 814 companies, or 4.6% exported over US\$ 10 million, totalizing US\$ 62,5 billion, 85.5% of the US\$ 73,1 billion exported by the country. When considering only the companies that export over US\$ 100 million, the level of concentration grows, which means 117 companies with a total of US\$ 42,6 billion represent 58% of the financial amount. In this context, we can evaluate that the credit access is not the same to all kinds of exporters. In relation to the official mechanisms, two aspects come up: first, these mechanisms operate according to risk management and product distribution principles, which select the large companies (low risk) and the traditional clients of those agents (banks), mostly private. Thus, the public or official mechanisms end up concentrated in a restricted group of exporting companies, which, in general, also have access to private credit sources.

In the private financing, only the ACC (Advance of the Exchange Contract, granted before the merchandise is shipped) allows credit access to a larger number of exporting companies. Even so, the financing conditions (costs, amounts and terms) act against the small and mid-sized companies, whose risk the banks believe to be above the desired level. As the Central Bank determines to rank the credit operations in a rising level of risk, and the doubtful stipulation to face the liquidation credits must be constituted monthly, according to the percentage related to the rating attributed to the credit, it directly impacts in the operation revenue. For instance, if the company is rated “C”, which is a good evaluation, the bank stipulates 3% of the value of the operation. If it is “D”, which is common, the bank stipulates 10%.

In a research carried out by FUNCEX- BNDES about the responsible factors for the frustrated efforts to contract the export financing, the small and mid-sized companies pointed out the following characteristics: real guarantee demands, financing conditions (terms/ costs) and the bureaucratic/ legal obstacles. All these factors directly interfere in the costs involved in the product placement in the international market. Thus, the small and mid-sized companies often face difficulties to specify their export product, to settle on the best price and to manage the distribution in the foreign market. The buyer – an international wholesaler – and the following segments of the trade channels are in a favorable position, gaining advantage over the exporter.

It is up to the players in this market to find the solutions to make the financing to the foreign market viable, whether with government or private mechanisms. In the dairy industry, for instance, milk is separated in various components and then reconstituted in many different forms to satisfy the consumer’s taste: low-fat milk, fat milk, milk cream, light milk cream, etc. Also, the financial innovations must decompose the risk and repack it in parts in order to attract various kinds of financing mechanisms and risk takers.

Competition Policy in European Union

By Robert Walton

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Everyone knows that competition promotes economic efficiency and therefore economic success. European Union competition policy ensures healthy competition is not hindered by anticompetitive practices and prevents undertakings from improperly exploiting their economic power over weaker companies, known as "abuse of a dominant position". Additionally, it seeks to prevent governments from distorting competition through state aid.

The European Community (EC) rules on competition are codified in Title VI, Chapter 1, Section 1, articles 81 to 89 of the EC Treaty. Articles 81 and 82 are the main pillars of European Community competition law applying to private firms. These rules have been enacted to allow competing firms to compete on a level playing field.

Article 81 prohibits any trade practice or restrictive agreement that would prevent, restrict or distort competition within the common market. This article restricts directly or indirectly fixing purchase or selling prices or placing any other trading condition on the sale. Under this article it's illegal to set the resale price or even offer a suggested selling price. It's also illegal to grant a party a sole sales area under an exclusivity agreement or to offer dissimilar conditions on equivalent transactions with other trading parties. To summarize, Article 81 forbids price-fixing; production quotas; sharing markets, and restrictions on customers or geographical areas.

Article 82 of the EC Treaty restricts abuse of a dominant position. The article states that "any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States." A dominant position is a situation in which a firm, because of size, hinders effective competition in the market. It outlaws the imposing of unfair prices or other unfair trading conditions, limiting production, and like Article 81 applying dissimilar conditions on equivalent transactions with other trading parties. Under Article 82, company mergers, because they can strengthen a dominant position, must receive advance approval by European Community authorities.

Now with that said, there are exemptions to these rules. The intent of these rules is to eliminate anti-competitive practices, but a firm must first have the ability to influence the market. But what if you are a small firm with no ability to influence the market? Well, the European Commission understands that and has taken the view that certain agreements, while in violation of the articles, should not be considered to violate the articles. These are basically agreements of minor importance (the *de minimis* principle), which are generally considered to be incapable of affecting competition and actually useful in that they encourage cooperation between small and medium-sized enterprises.

Bottom line is in the European Union, rules on competition are strict. If you are a small company, then you will most likely not be affected by the rules on competition, but its best practice in the European Union is to treat all parties equally, don't offer suggested resale prices and don't grant exclusive rights. If you are a larger firm and in a dominant position, then don't abuse it.