The EuroFuture Project

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Brazil-EU Relations: Beyond the Eurozone Crisis

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Summary: The debate in Brazil on the future of Europe is still superficial, but has a particular concern for the impact the crisis will have on its growth rate. There have been adjustments in the expansion plans of Brazilian companies that were already operating in Europe before the crisis began, and many other Brazilian multinational corporations have gone bargain hunting in Europe. Europe is still not considered as friendly place for business as the United States, Japan, or even China. This has diverted Brazilian investments and companies to other regions where regulations are less burdensome. A more pragmatic approach is needed to establish rules enhancing competitiveness in the European labor markets, with easier immigration rules to attract foreign talents. While the new Brazil is not entirely dependent on Europe for its future growth, Brazil should look to Europe as a vital partner in building the new world order.

How the Mess in Europe Affects Brazil

What the European Union[1] — one of Brazil´s largest trading partners — will be like after the euro crisis remains a mystery. The euro, not Europe, is in crisis. Brazil, a survivor of many economic crises, is an example that such crises should inspire Europe to reassess and renew its role on the world chessboard and build more resilience into its integration process. Getting back on track, however, has been much slower than expected and shows that Europe still faces many internal doubts about its future. This crisis is not the euro´s fault alone. It is also the fault of the lack of leadership, common vision, and discipline in fiscal matters.

The euro, despite having deprived individual countries of flexibility in setting monetary and fiscal policy, has been essential to expedite financial exchanges and lower transaction costs in Europe, with a positive impact on economic growth in the last decade.[2] However, the lack of fundamentals, such as a unified fiscal policy, uniform banking regulations, and a more solid and more democratic governance, have backfired, a direct result of the "we want integration, but not so much" approach.

The crisis has increased the divide between North and South, East and West, between more and less endowed economies. The latter have greatly benefited from the transfer of community funds.[3] This divide may be the root of future crises if Europe fails to address this challenge.

The Brazilian debate on the future of Europe is still superficial, but has a particular concern for the impact the crisis will have on its growth rate. Brazilian companies, already operating on the continent before the crisis, have been revaluating whether it would make sense for them to continue operations. On the other hand, the crisis has been an incentive for Brazilian companies willing to

1 Brazil was one of the first countries with whom the EU has established diplomatic relations. Since the EU-Brazil Summit in Lisbon in 2007, Brazil has been recognized as one of its main global interlocutors by the EU-Brazil Strategic Partnership in order to strengthen co-operation and develop a deeper dialogue. Issues such as climate change, the international financial crisis, and regional situations have created a positive, yet developing relationship.

2 Around 330 million people live in the eurozone, where the average inflation rate stands at 2 percent.

3 Those member countries failed to put these funds into productive use, spending on public or private consumption (Greece, Portugal) or booming the residential construction sector and over-sizing the exposure of banking sectors (Ireland and Spain).

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integrate their production chains to acquire crisis-affected assets.

For quite some time, Brazil and Latin America were off the European radar, considered more of an Iberian matter, with Portugal and Spain playing an important interlocutory role. Despite some initiatives, discussion of closer economic cooperation has moved at a turtle's pace on both sides of the Atlantic, particularly due to Brazil´s insistence on the reduction of European subsidies on agriculture, still an unresolved matter. As a consequence, trade has not been as intensive as it could be, despite the fact that Europe buys Brazilian manufactured goods.

The European crisis has had an impact on Brazil in three different areas:

- the spill-over effect from Europe´s trade reduction with its current number one trading partner, China, now Brazil´s main trading partner, too;
- the decrease in exports to Europe due to protectionist measures; and
- an overall impact of the European crisis in worldwide growth, which has affected the Brazilian GDP, reducing the expected growth from 3.5 percent to 2.5 percent in 2012.[4]

According to the World Trade Organisation (WTO),[5] Brazilian exports were reduced by almost 17 percent in the last quarter of 2011 and the first quarter of 2012, as a result of the European crisis and slowing growth in China.[6] The administration of President Dilma Rousseff has pursued countercyclical measures to address the situation, in an almost desperate effort to raise consumption as a driving force to generate growth in a bearish market.

When it comes to investments, there has been a dual scenario. The expansion plans of Brazilian companies that were already operating in Europe before the crisis have been adjusted. An example is Marcopolo,[7] which opted to shut down operations due to the slow growth. On the other hand, as the crisis continues, many Brazilian multinational corporations have gone bargain hunting in Europe. As a result, Brazilian policymakers should secure the protection of Brazil's ever growing interest in European companies in order to integrate supply chains. European investors have sought profits from their operations in Brazil, a country with a comparative advantage over the other BRICS due to its positive response to the crisis and to its democratic stability.[8] This has prompted European companies to expand investments, despite the infrastructure challenges and the cost of doing business in this emerging market.

Europe will remain an important player in world affairs and globalization, despite the bumpy road ahead. The European integration model, however, which had been considered the most appropriate for a region like South America, is no longer perceived as a model. Nonetheless, together with the United States and China, Europe will still play an essential role in globalization, even though it will be the third voice in that troika.[9] Since globalization seems an irreversible trend — it should be remembered that Europe was globalized long before the term became widely recognized — and will continue after the dust of the current crisis settles, the Old Continent will be much stronger, with a promising future. It will, however, need to

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4 The Brazilian GDP expanded 0.20 percent in the first quarter of 2012. In 2010, the GDP growth reached 7.5 percent, the highest in the past 25 years. However, it slowed down to 2.7 percent in 2011, with expected growth at 3.2 percent in 2012. New Brazilian Central Bank projections foresee it at 2.5 percent for 2012.

5 World Trade Organisation, *World Trade 2011, Prospects for 2012*, July 2012, http://www.wto.org/english/news_e/pres12_e/pr658_e.htm.

6 World Trade Organisation, *Brazil Country Profile WTO Report*, July 2012, http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=BR.

7 Marcopolo, a major Brazilian bus body producer, shut down its operations in Portugal in 2009 as a result of its poor performance in the European market.

8 An investment concept yet to be proven feasible as a political bloc, this term was coined by Jim O´Neill of Goldman Sachs in 2003 to refer to the emerging economies of Brazil, Russia, India, and China, forecasting that such economies by 2050 would be larger in United States dollar terms than the G6 (United States, Germany, Japan, United Kingdom, France, and Italy). In 2011, upon invitation by the BRIC countries, South Africa joined the bloc.

9 The financial G20, relevant as it may be, has yet to become a more organized body for collective action, so the reason the troika composed of the United States, China, and the European Union will still remain the most relevant players of the international system.

make adjustments to become one true federation, with one common voice and goal.

Europeans will need to expand the mandate of the European Central Bank (ECB)[10] and reassess their perspective on the preponderance of Germany as the key player of its future. Germany, on the other hand, will need to become more flexible, particularly in terms of its financial policy. This new Europe will not be as relevant to Brazil, China, or the United States unless there is a concerted effort to change.

What Went Wrong in Europe?

Transparency, a growing lack of popular support reflecting a fatigue towards Brussels, and a disregard for local communities have been the EU´s greatest challenges during the crises. The integration process has concentrated too much power with elites in Brussels and has failed to foster a common, federal identity. This tension between federalism, opposed by some, and commercial pragmatism, expected by many, has been a driving force that at times expedites the pace of integration, but also restrains it from deepening. Reconciling such conflicting views remains the fundamental challenge to further integration.

The euro was introduced as a tool to achieve integration. This was done without all the necessary instruments in place in order to ensure success. Glaringly absent was a common fiscal policy to ensure austerity and sound financial practices by the governments, whose unique histories, cultures, demographic identities, and different perspectives on state sovereignty, have produced heterogeneous needs and goals.

The common currency should have played an important role in encouraging convergence. However, the eurozone failed. Under the umbrella of the common currency, it included differing ethics and perspectives on the future. As in an orchestra, the countries wanted to play the same song, but they were on different pages. The entire process demonstrated a lack of strong political leadership[11] for a common vision.

10 The ECB was conceived to maintain price stability in the eurozone, applying the no bail-out principle, whereby no states within the system would be financed if needed. Though a temporary success, this has been proven unsustainable in the long run.

11 Several countries have changed their heads of government during the crises, not as a result of an ideological shift, but mainly because of the incapability by those in office to deliver better responses to the situation.

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The European crisis provided evidence for the inexistence of preventive tools to address the issue of moral hazard in public debts, with neither the ECB nor the European Commission (EC) equipped to solve financial imbalances. When developing such, they resorted to traditional International Monetary Fund (IMF) policies to reduce fiscal deficits and stimulate growth and international competitiveness, without the necessary access to loans or monetary policy instruments generally available under normal IMF interventions. The ECB was not designed to act as a lender of last resort, only as an instrument for inflation control.

This has added instability and volatility to world financial markets, with investors becoming more risk averse, especially to sovereign debts. The delay in solving the Greek problem, a weakness of the European leadership's ability to control the situation[12] and address the challenges, has imposed heavy costs on Ireland, Portugal, Spain, and Italy. Though the adjustment measures may be considered excessively difficult to meet, there is no other real alternative to austerity in handling the crisis.

Lessons Learnt from the Crisis

Three important lessons should be taken from the euro crisis:

- inflexible labor laws and major welfare benefits have reduced the speed and competitiveness of an economy;
- the depreciation of currencies and the increase of labor productivity in the United States and Japan should be

12 The IMF 2012 World Forecast has shown that the European financial problems and weak recovery has delayed world economic growth. International Monetary Fund, *IMF Survey*, July 2012, <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW071612A.htm>.

matched immediately with the application of similar policies; and

- loose fiscal policies have led to irresponsible public spending in countries not used to an abundance of financial resources, enhancing moral hazard challenges.

The crises have shown that Europe has been losing its capacity to innovate and compete in the global market due to the high cost of business. The cost of the welfare state in Europe is also a relevant lesson. Since Europe does not enjoy the benefit of the demographic bonus, like Brazil currently does, the low fertility rates will force it to open up borders to immigration in order to secure growth and sustain the welfare state set up after World War II despite some domestic opposition. This inflow of foreign workers will be necessary for the preservation of the current standard of living.

Labor flexibility has been a stumbling block for European capitalism, with an over-regulated labor and business environment. Europe is still not considered as friendly a place for business as the United States, Japan, or even China. This situation has diverted Brazilian investments and companies to other regions where regulations are less burdensome, while companies still prefer to do business in markets in which they are familiar. A more pragmatic approach is needed to establish rules enhancing competitiveness in the European labor markets, with easier immigration rules to attract foreign talents.

The New Brazil and Europe

Independent from what takes place in Europe, there is an ongoing tectonic shift in geopolitics, with power moving slowly from West to East and a direct impact on world order. With a world globalized in a multipolar framework, Brazil and Europe share common values and perspectives on the preponderance of soft power as a substantial instrument of foreign policy. The European Union has reacted positively to some of Brazil´s calls to reform the Bretton-Woods institutions and the United Nations´ Security Council, two substantial challenges towards repositioning the global system. Peaceful coexistence with neighbors and increased cooperation in technology-sharing and collective security are driving forces of such relations. However, global governance, with the accompanying growth of multilateral dialogue, constitutes the most pressing item for

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Brazil, a country that has undergone a profound transformation in the last two decades and is now seeking an ever-increasing role on the global chessboard.

While a newcomer, Brazil has the sixth largest economy in the world[13] and has become an economic and political powerhouse. A South-North Atlantic Alliance, with a closer association between the so-called New Brazil — currently, a rule taker willing to become a rule-maker — and Europe — a unique global player that still lacks the traditional attributes of a power, particularly in military terms — is essential for the South American country to play in the big leagues and actively contribute to building a better global society.

In spite of global financial difficulties, Brazil's positive economic results have increased its recognition as a global player in a multi-polar world, particularly at the G20 level. The presidential diplomacy of Lula da Silva, a typical Weberian charismatic authority, had an important role in the process. During Lula´s term, Brazil, no longer haunted by economic turbulence and political instability, incrementally became a more relevant global player. It sought an active role in global governance, either in the quest for a permanent membership at the United Nations´ Security Council, an old diplomatic claim, or in its several appointments, though unsuccessful, for key leadership positions in major international organizations. Though Lula´s asser-

13 Brazil has claimed the United Kingdom´s previous place as the world sixth largest economy in 2011, due to its 2.7 percent growth against the U.K.´s 0.8 percent. The five largest world economies in 2011 were the United States, China, Japan, Germany, and France.

tive foreign policy failed at times,[14] it raised Brazil to a new status on the global chessboard.

Brazil, together with the other BRICS, has confronted the traditional dominance of the United States and Europe, pursuing a path to influence global decisions, particularly with the economic challenges currently in place. Brazil´s access to abundant natural resources and energy has made its currency one of the hardest in a world hungry for such assets. As labor abundance and exports have enabled China to become an economic powerhouse, natural resources should serve as an important source of revenues and power projection.

Brazil is different from the other emerging powers since it faces no major threats of war, domestic disruption, or nuclear claims. Its borders are settled. They have been unchallenged for more than 140 years. A demilitarized South America has allowed heavy reliance on soft, instead of hard power, to assert influence in a region that still resists Brazilian leadership. Whether or not this is durable will be determined by the sustainability of its economic performance. Brazil is now widely recognized as an important actor with more prestige, and this prestige plays a critical role. As Morgenthau put it, "what others think about us is as important as what we actually are." Hopefully, such prestige may create a self-fulfilling prophecy whereby the country makes the necessary adjustments to meet global expectations. Considering its developing background, on political and ideological terms, the Brazilian foreign policy establishment may occasionally have a hard time internalizing the responsibilities of a great power and the corresponding behavior and level of accountability.[15]

A New Phase in the Bilateral Relationship

Brazil has a long historical relationship with Europe. From Portugal, where the colonizers originated, to Germany, source of one of its largest immigrant populations, and to the U.K., initially responsible for the Brazil's industrialization, Europe has been a source of inspiration and

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economic, commercial, and political synergy. This bilateral cooperation is ever more relevant today.

The financial and euro crises have inaugurated a new geopolitical phase, with Europe and the United States stepping sideways to accommodate new powers. In this new order, Europe, with only two states armed with nuclear weapons — yet a military power larger than China and India combined — will continue to rely heavily on soft power as its main foreign policy instrument.

Brazil has greatly benefited from the Chinese ascension, the most relevant phenomena of the early 21st century. Their hunger for commodities has made China Brazil´s largest trading partner since 2008. Chinese imports have helped decrease dependence on traditional markets, like Europe and the United States, and addressed the needs of a growing middle class.[16]

With added prestige on the international scene, based solely on economic performance, Brazil has sought global activism, particularly in international organizations, to affirm that a "contested" regional leadership should not be regarded as a deterrent for global emergence. Though unlikely to upset the international system, Brazil has sought to become a traditional power with a global role.

This temporary economic bonanza is still a new thing for Brazil. Historically, the country has relied primarily on foreign savings to support domestic growth. The discovery of offshore oil should expand its revenue sources, hopefully allowing several sectors in the economy to access domestic savings that were previously unavailable. An increase in military power will be necessary to protect offshore

14 While setbacks, the Honduras ordeal with President Manuel Zelaya and the joint mediation attempt with Turkey regarding the Iranian nuclear activities should be considered as justification to not play a more global role. The concepts were correct. The homework and the job done were not.

15 This third worldism perspective may explain why Brazil, during its last term as a non-permanent member of the UN Security Council (2010-2011), continuously abstained in many issues presented for vote.

16 Governmental income transfer programs, such as Bolsa Familia, added 40 million new consumers into the domestic market. Brazilian industrial output was not sufficient to meet demand, with China playing an important role in reducing inflationary pressure.

resources. The "resource curse," with the predation of natural resources, is a concern, even though the dimension of the country and the multi-layered level of industrial base may be an antidote. The political definition of the use of such resources should have a long-term perspective for the welfare of future generations. Thus, petroleum exploration is expected to reach a dual target:

- to provide economic resources for development consolidation; and
- to serve as a tool of foreign policy to address energy security needs of major world powers.

Whether oil can address both issues is still to be determined.

By introducing structural changes in the oil exploration regime — from concession to partition — the current Brazilian government clearly signals its firm belief that oil should serve as a tool to increase its international weight and strengthen ties with key partners, particularly China, United States, and Europe. By becoming a reliable supplier for their energy needs, Brazil should counterbalance the instability of North Africa, Middle East, and Russia.

The new Brazil faces crucial challenges ahead: an expensive welfare state, a major dependence on commodity exports, an overvalued currency, and high interest rates, if compared to international standards. Yet, despite these unfavorable aspects, the country has low unemployment, rising wages, rule of law, high agricultural productivity, and ever increasing foreign direct investment, greatly supported by a growing middle class.

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Europe will remain an important market and partner for Brazil due to cultural ties and a common agenda yet to be built. Should Europe not resolve its financial and, more importantly, its identity crisis, Brazil, as an emerging global power, might be tempted seek improved relations with other partners. It is important to stress that the Rousseff administration has not been as engaged internationally as its predecessor. This level of disengagement, due to the poor performance of domestic growth, should not remain a policy goal, particularly now where Brazil´s inputs are expected on several squares of the global chessboard.

The Brazilian experience has proven that crises have invariably had a short-term negative impact with positive long run results. The current crisis should be a new moment for Europe to rethink its positioning strategy in the global scene. A common agenda for Brazil and Europe for the near future should be developed including:

- education and immigration;
- trade; and
- collective security.

Education and Immigration

The Rousseff administration has launched the "Science without Borders Programme"[17] for thousands of Brazilian students to attend universities abroad and pursue further advanced degrees. European Union member states should become major recipients of Brazilian students for research and graduate education. By outsourcing a part of its higher education to countries with better educational systems, Brazil expects to become more competitive upon the return of those trained abroad. Taiwan, South Korea, and China have successfully pursued a similar strategy over the last 50 years. The more Brazilians live and study in Europe, the more the ties will increase, with a positive outcome for the future of this transatlantic relationship.

Unemployment has reached worrisome levels in Spain, Portugal, France, and Italy. Aside from being a social problem, unemployment is a waste of the best talents. Brazil should be able to attract more European brains in the current situation, due to its strong growth and the lack of a skilled workforce. A steady increase in European

17 The program still needs improved regulation, particularly by opening up all areas of human knowledge and developing an easier process to recognize foreign certificates and diplomas. The bureaucracy may actually kill the program.

immigration to Brazil has been observed since 2008, a first since the early 1940s. As Brazil opens up its borders for European immigration, a bilateral agreement should be worked out to open the borders for workers on both sides and to foster greater economic interaction.

Trade

For every $2.00 invested in Brazil from Europe, there is $1.50 invested back by Brazil.[18] The European crisis has represented a unique opportunity for Brazilian capitalism to become more competitive internationally, with Brazilian companies acquiring crisis-affected assets and businesses in Europe in order to integrate production chains. Brazil and Europe should pursue deeper economic integration and capitalize on new opportunities to be developed jointly, crossing investments and creating new markets for technologies, particularly energy, which Brazil has in abundance. A closer partnership would accelerate more joint ventures and economic growth. Joint developments should take place in the pharmaceutical industry, particularly for the development of tropical disease medicines.

Collective Security

In the aftermath of the Libyan intervention, Brazil proposed a new approach for UN operations, the so-called "Responsibility While Protecting." This concept focuses on the need to improve the monitoring and assessment of UN Security Council-sanctioned use of force and the need to exhaust all peaceful means before using it. Countries operating under a UN mandate should set up the necessary tools to protect civilian populations throughout the intervention process.

In the meantime, the Brazilian defense system will need greater improvements to be deemed more effective. Cooperation programs with technology transfers are essential for Brazil to rebuild its defense industry, particularly to secure the regional commitment of South America remaining a peaceful zone. Brazil and Europe should establish mutually beneficial procurement policies to advance Brazil´s defense of offshore assets and to improve military actions under a UN mandate.[19]

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The Cold War has been over for more than two decades, but not much has changed in the world chessboard. When it comes to the UN Security Council, Europe should consolidate its voice. Do France and the United Kingdom represent themselves or are they the voice of the European Union as a whole? European over-representation in many international organizations constitutes a major concern for emerging countries in the process of reassessing global governance.

Conclusion

The challenges Europe has faced have a direct impact on the role it will play in the world in the years to come. Europe and the West are steadily declining in importance and power, with Asian countries, particularly China, playing an increasingly powerful role. In order to remain relevant, Europe should consolidate its integration process, and continue to build a single Europe, with unified foreign, security, and fiscal policies.

As the new global chessboard is set, Europe will need to decide on the depth of its integration process. The European identity should prevail over the national. A "Euro-

18 According to the Brazilian Central Bank, Brazilian investments in 2011 reached $202.5 billion, an increase of 7.4 percent in relation to 2010. The European Union is ranked as the number one recipient of Brazilian foreign direct investment.

19 The so-called "Buy Brazil Act," whereby government procurement should favor Brazilian-made products, is counterproductive for a country seeking a more active role in international trade. This act is another evidence of the trend Brazil still faces of falling into third worldism views of economic growth. Also, Brazil historically has not been a free trader due to attempts to protect its domestic industry.

pean with no regrets" approach should be the driving goal of member countries to forge such identity. Europe must pause and review what has gone wrong. A divided house will remain Europe´s Achilles´ heel and its greatest challenge. Europeans will need to rediscover the benefits of integration, survive the current troubles and learn to live with current and future German preponderance.

A "One Europe Policy" should be pursued as the driving force. Historical differences, though important, should be left behind in order to address the challenges of a much more competitive world. Constructing a true European identity is a work for generations. EU countries should understand that, if isolated with their small territories, aging populations, limited access to energy, and declining competitiveness, they will not be able to survive in the global market. The new Brazil is not entirely dependent on Europe for its future growth. However, if Europe plunges, the promise of a continuous economic prosperity for Brazil and the other BRICS will undoubtedly take a hit.

Crises come and go. So do governments. Policies and institutions, however, should be long lasting. Their strength is essential for longevity. Brazil should look to Europe as a vital partner in building the new world order, with increasing influence over emerging countries, who should take over more responsibilities in the international arena.

Brazil is growing up. And so is Europe.

About the Author

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About The EuroFuture Project

The German Marshall Fund of the United States understands the twin crisis in Europe and the United States to be a defining moment that will shape the transatlantic partnership and its interactions with the wider world for the long term. GMF's EuroFuture Project therefore aims to understand and explore the economic, governance and geostrategic dimensions of the EuroCrisis from a transatlantic perspective. The Project addresses the impact, implications, and ripple effects of the crisis — in Europe, for the United States and the world.

GMF does this through a combination of initiatives on both sides of the Atlantic, including large and small convening, regional seminars, study tours, paper series, polling, briefings, and media interviews. The Project also integrates its work on the EuroCrisis into several of GMF's existing programs. The Project is led by Thomas Kleine-Brockhoff, Senior Transatlantic Fellow and Senior Director for Strategy. The group of GMF experts involved in the project consists of several Transatlantic Fellows as well as program staff on both sides of the Atlantic.