Section 2 New Trade Partners:
MERCOSUR, rapidly expanding the trade led by Brazil

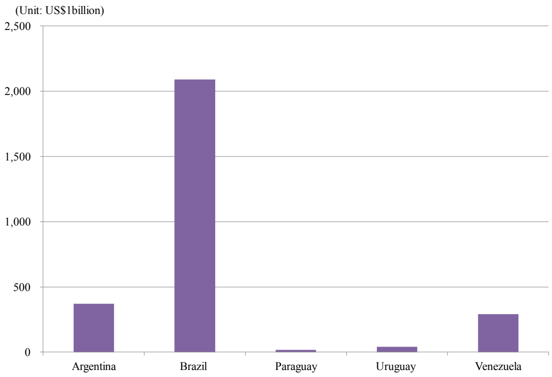
1. MERCOSUR Overview

(1) MERCOSUR from macro viewpoint

It was pointed out in the Chapter 2, Section 1 that the MERCOSUR' increase rates of trade amount comparing with that of 2008 to 2000 were 13.7 times increase in China – MERCOSUR, 5.1 times increase in ASEAN – MERCOSUR, thus the presence of MERCOSUR was increased. Also a result was found by the gravity model that trading cases where trading partner was China, MERCOSUR ranked higher in the trade amount increase rate / GDP increase rate. According to the IMF statistics, the MERCOSUR's GDP size is a total of US$2,810 billion, which consisted of Argentina (US$370 billion), Brazil (US$2,090 billion), Paraguay (US$18.5 billion), Uruguay (US$40.3 billion) and Venezuela[1] (US$290.7 billion).

Argentina and Brazil are outstanding in the GDP share in the five nations, i.e. 74% in Brazil, 13% in Argentina, 10% in Venezuela and 1% each in Uruguay and Paraguay. The economic movement in MERCOSUR is essentially affected by that of Brazil, Argentina and Venezuela, especially Brazil (Figure 2-2-1-1).

Figure 2-2-1-1 Nominal GDP of MERCOSUR (2010)



Notes: Value is estimated for Brazil.
Sources: IMF "World Economic Outlook Database April 2011"

Recently, China's presence has been increasing in Central and South American regions. Responses to China's presence in the region is said to differ from country to country[2]. The responses can be divided

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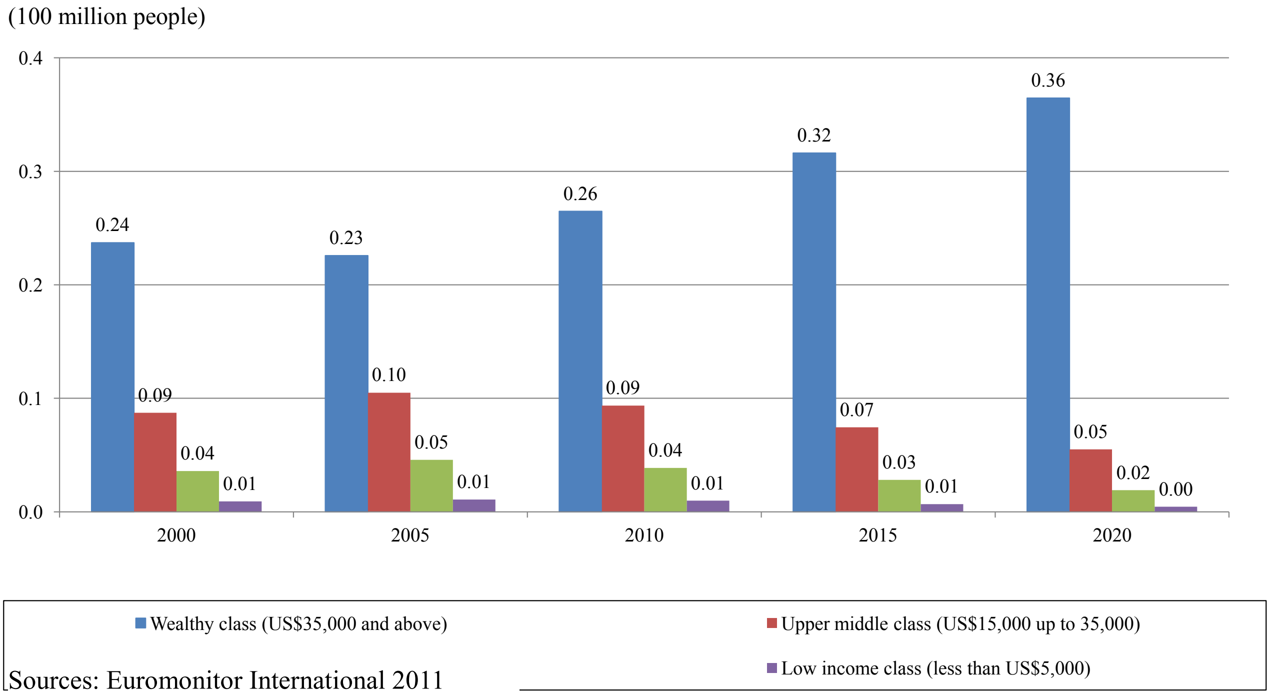
[1] Formal membership of Venezuela is not presently completed for delay in congressional ratification. Currently, the nation attends the meeting without any voting right.

[2] Refer to "Increasingly Expanding China's Presence and Currency in Recent Central and South American Region, and movement of cooperation in the monetary affairs" by Matsui, K. Senior Researcher, Institute

into 2 groups; one group becomes cautious to the expansion of China's presence, which is a group of Central American countries and Mexico is competitive with China in sewn products export to the United States. Another group is the dominant countries in MERCOSUR such as Brazil, Argentina and Venezuela. Although having some small conflicts with China, those countries have generally strengthened their relation with China. The situation should be verified. And discussing in relation with the Chapter 3, Section 1, the wealthy class is dominant in Argentina and Brazil and is led by the middle class, which is expected to largely increase.(Figures 2-2-1-2 and 2-2-1-3).

Figure 2-2-1-2 Transition of population by income group in Argentina

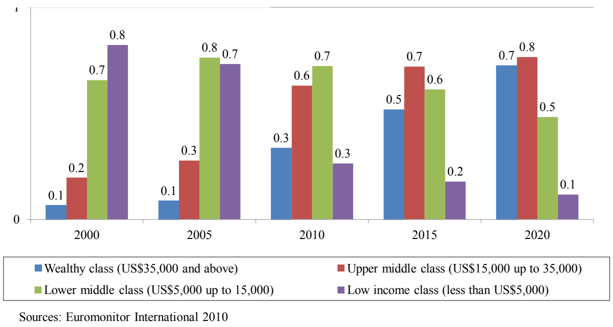


Sources: Euromonitor International 2011

Sources: Euromonitor International 2010

for International Monetary Affairs (IIMA).

Figure 2-2-1-3 Transition of population by income group in Brazil



Sources: Euromonitor International 2011

(2) Trade situation within the MERCOSUR region

There was initially concern about forming a common market and customs union in MERCOSUR due to large difference in the economic sizes between these countries, which were classified as larger countries including Argentina and Brazil and smaller countries including Uruguay and Paraguay. Examining share of each trade partner country, two patterns can be found, i.e. Brazil and Argentina with high mutual dependency, and Paraguay, Uruguay and Venezuela with high dependency on Brazil and Argentina. However, it should be noted that there was high trading dependency between China and each country in the MERCOSUR region in 2010 (Figures 2-2-1-4 through 2-2-1-8). Argentina and Brazil have the relation of mutual dependency, but Argentina's dependency on Brazil is higher than that of Brazil on Argentina. Brazil's export and import partner countries are distributed worldwide including China and the United States, and the trade has multidirectional structure (Figure 2-2-1-9). Brazil's export dependency on countries within the MERCOSUR region is 13% and the import dependency on those countries is approximately 10%. The percentages are not so high compared with other countries in MERCOSUR. The trade of countries other than Venezuela depends on countries within the region by approximate 30% to 50% (Figure 2-2-1-10).

Figure 2-2-1-4 Argentina's export and import shares within MERCOSUR and to/ from China (2010)

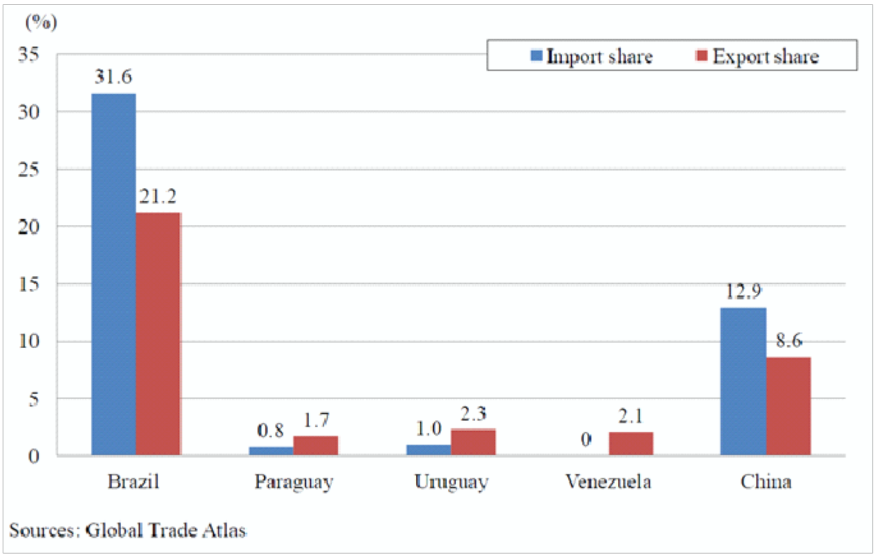


Figure 2-2-1-5 Brazil's export and import shares within MERCOSUR and to/ from China (2010)

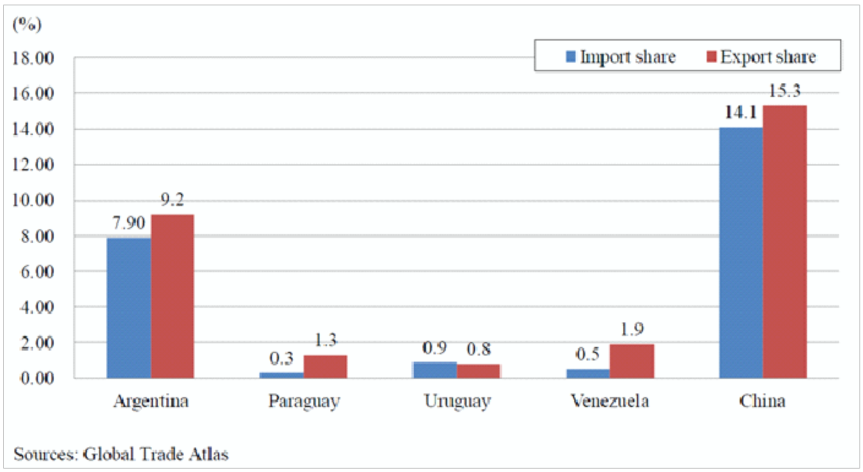


Figure 2-2-1-6 Paraguay's export and import shares within MERCOSUR and to/ from China (2010)

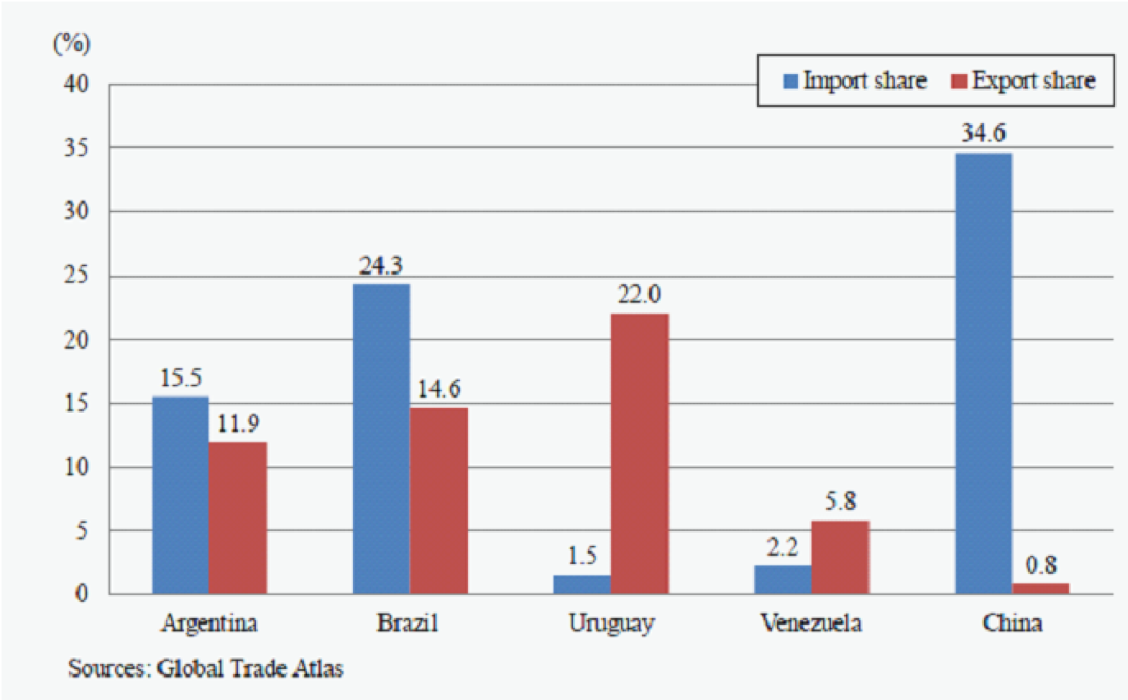


Figure 2-2-1-7 Uruguay's export and import shares within MERCOSUR and to/ from China (2010)

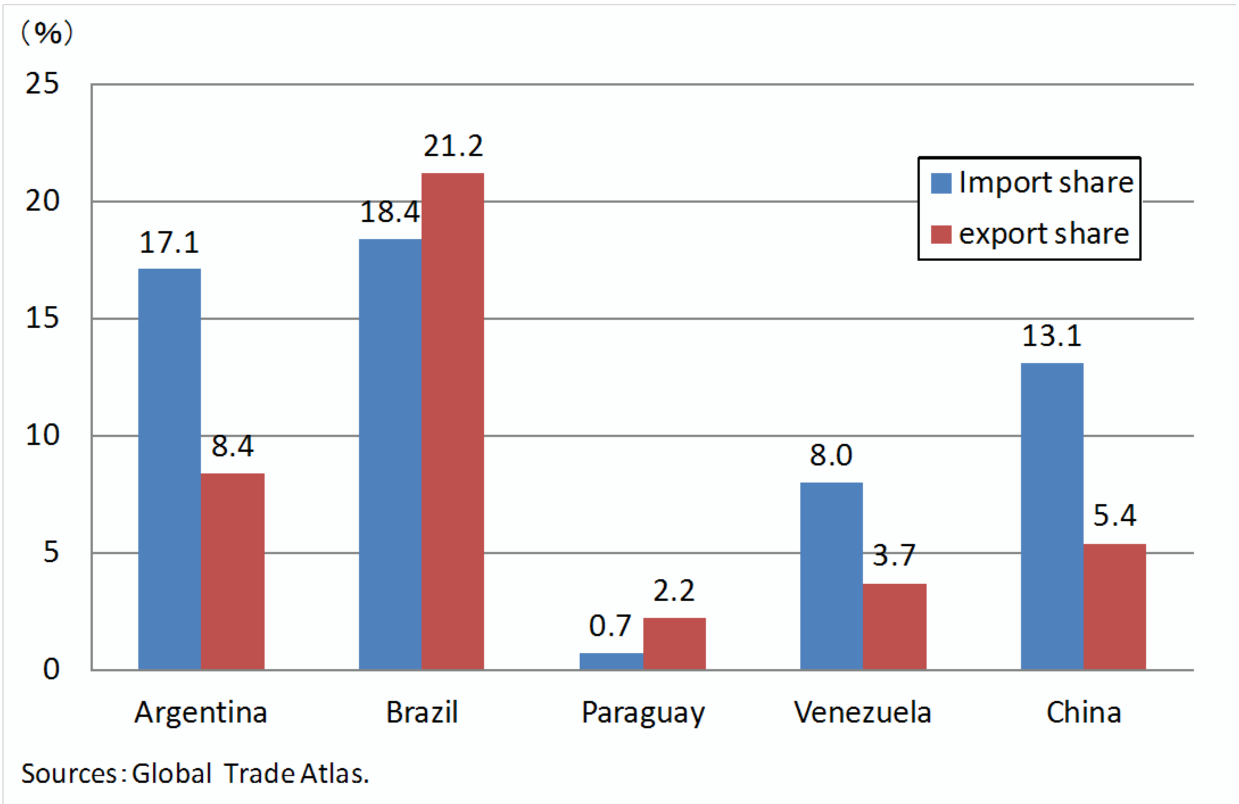
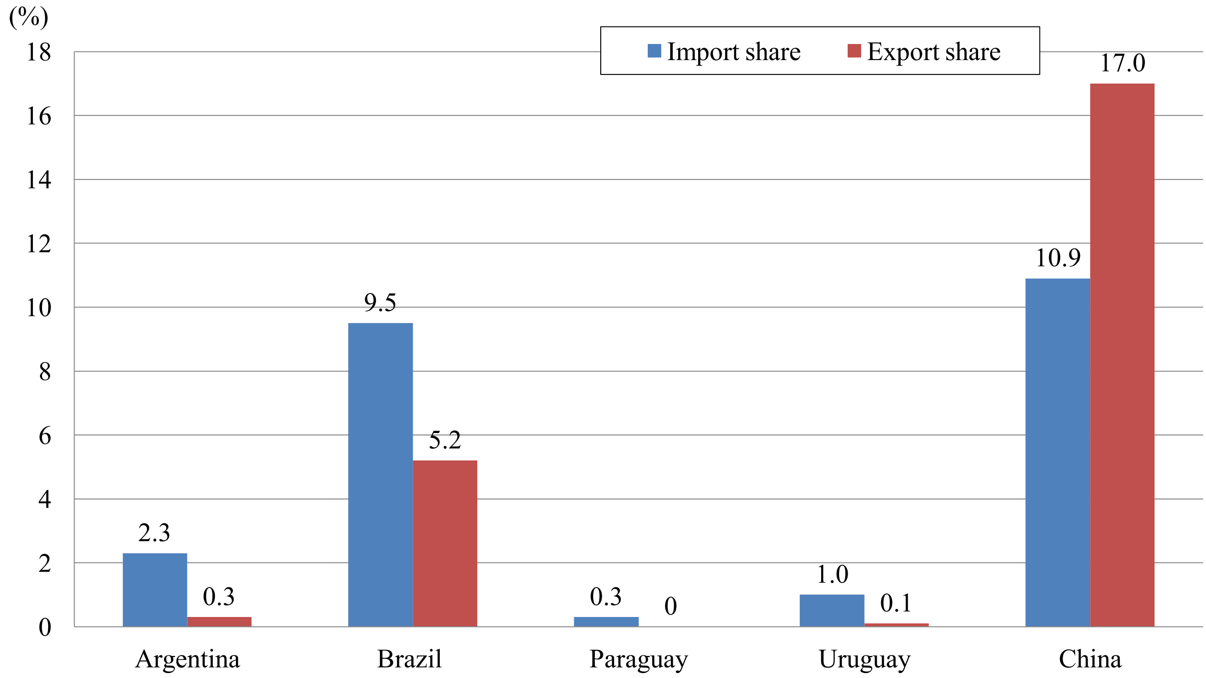
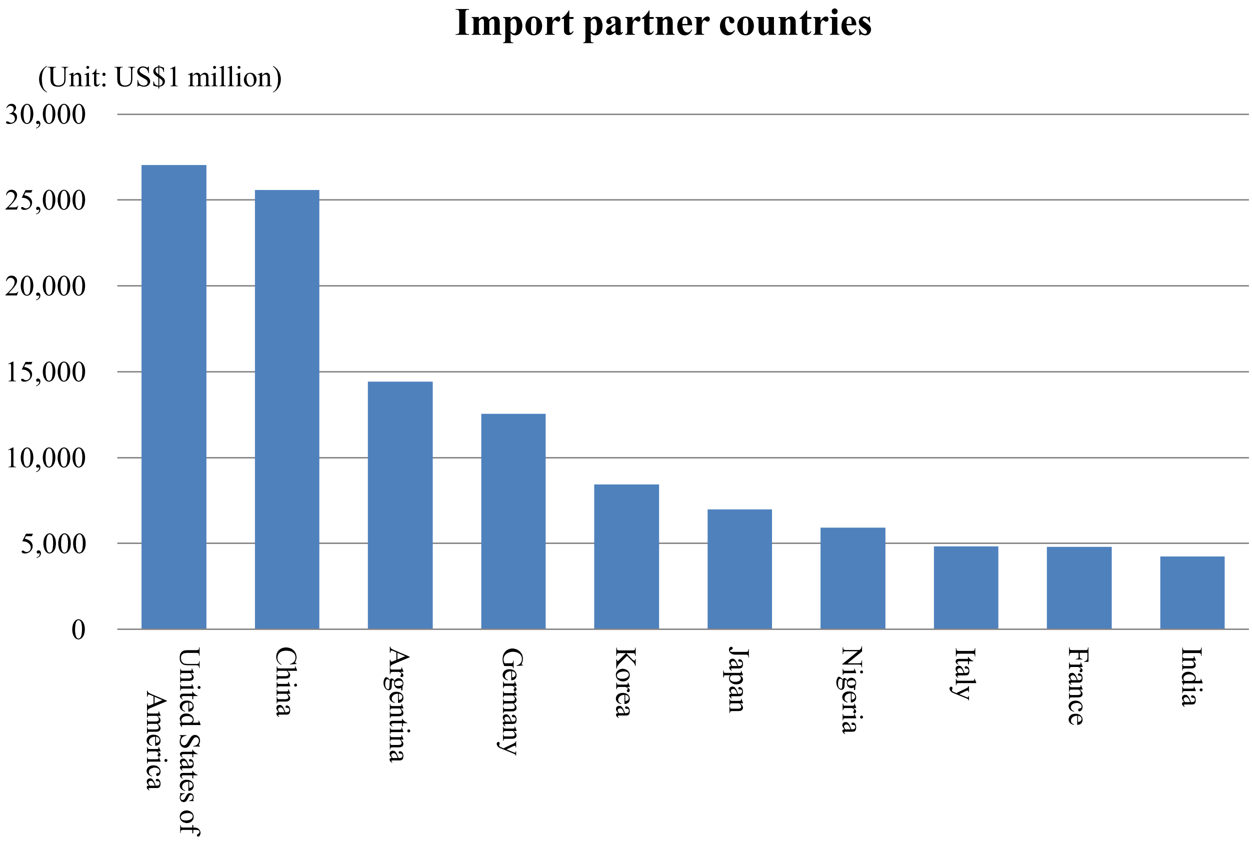


Figure 2-2-1-8 Venezuela's export and import shares within MERCOSUR and to/ from China (2010)



Sources: Global Trade Atlas.

Figure 2-2-1-9 Brazil's main export and import partner countries (2010)



Sources: Global Trade Atlas

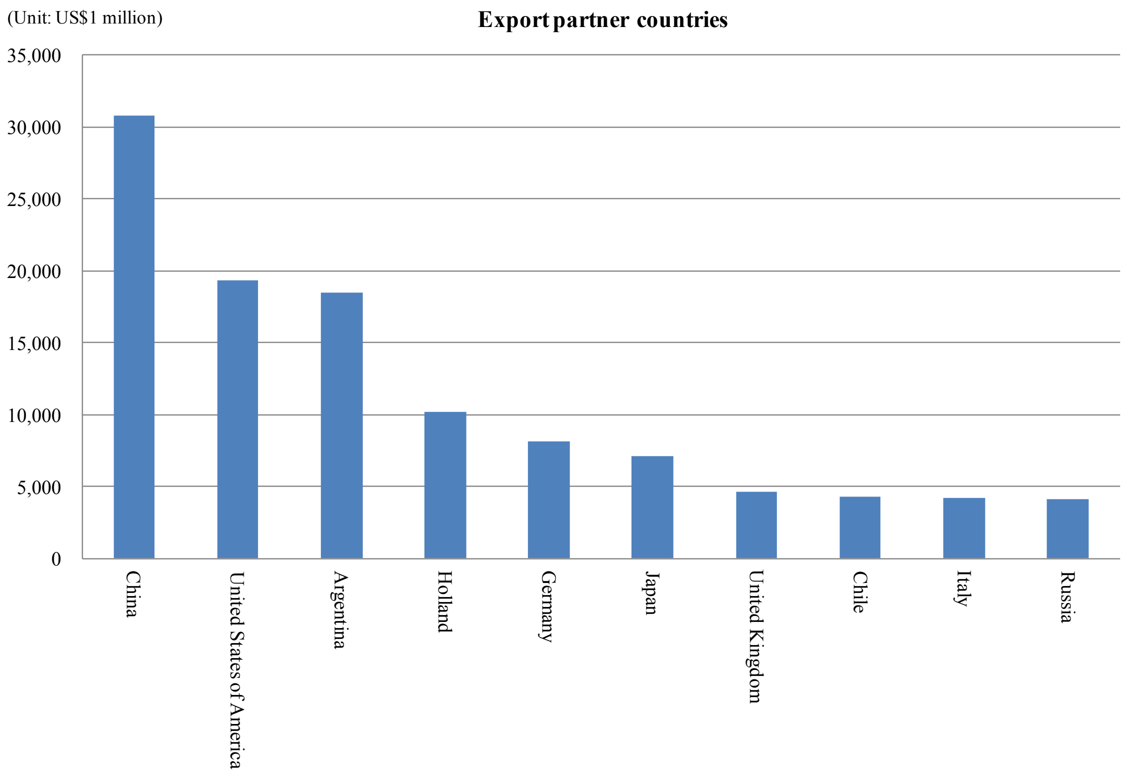
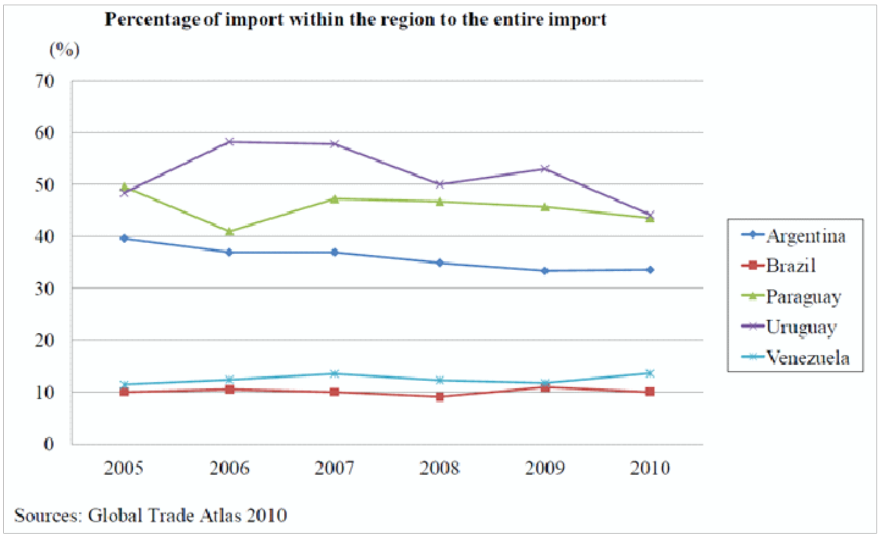
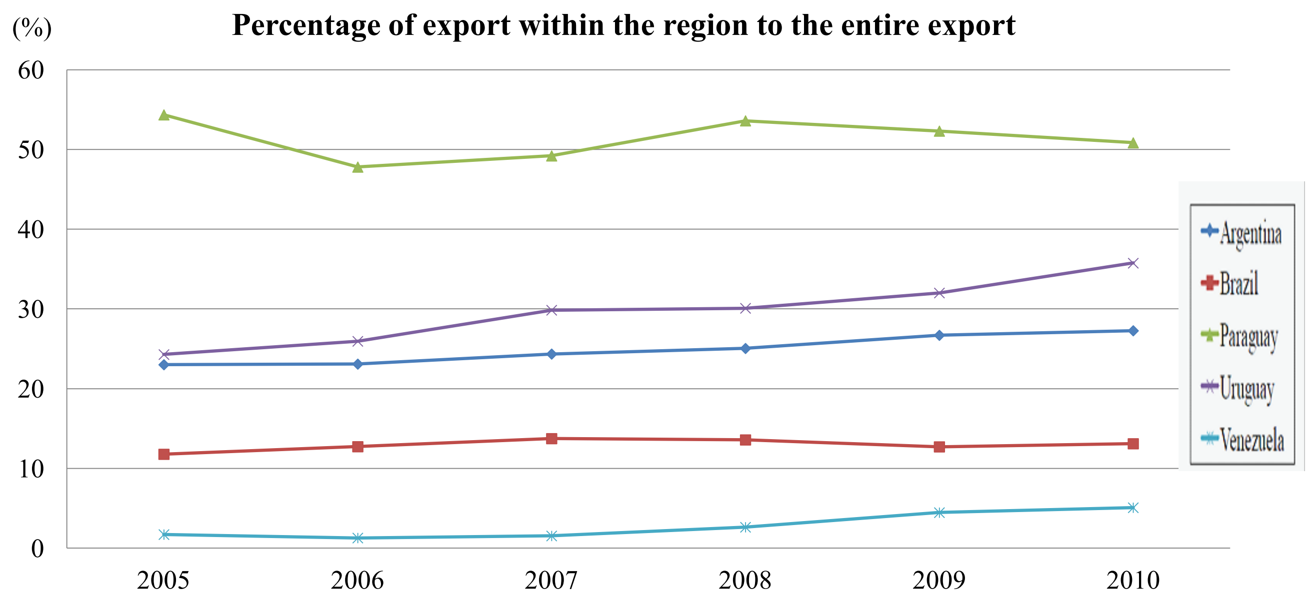


Figure 2-2-1-10 MERCOSUR countries' percentage of export and import within the region to the entire export and import





Sources: Global Trade Atlas 2010

The fact that is known from the data of these countries in the MERCOSUR region is that they form a "loose relationship" as an economic union. In EU and NAFTA, the trade within the region account for large percentages of each member country's trade, but in the case of trade within the MERCOSUR region, trade relation between 2 or 3 countries is not closely tied except between Argentina and Brazil. This may reflect the larger economic sizes of these 2 countries.

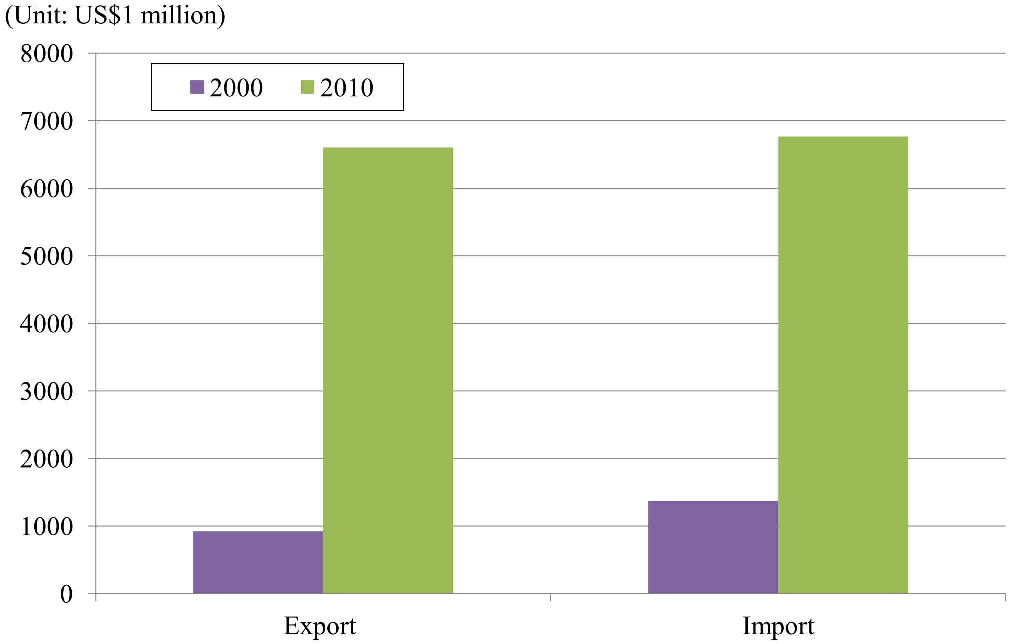
Then, it is notable that China shows its presence as a major trade partner outside the region as it does in all the five countries of MERCOSUR. As of this moment, it can be said that the countries of MERCOSUR have a structure that is tied with China individually.

(3) Trade with ASEAN, China, NAFTA and EU

(A) ASEAN

Examining the example of Brazil's export and import to/ from ASEAN, export from ASEAN to Brazil (or import from ASEAN to Brazil) was slightly less than US$1.4 billion in 2000, but it increased approximately 5 times to over US$6.7 billion in 2010 (Figure 2-2-1-11). Also, export from Brazil to ASEAN was US$900 million in 2000, and it reached to US$6.6 billion in 2010, almost the same amount of import.

Figure 2-2-1-11 Brazil's trade with ASEAN (2000 and 2010)



Sources: World Trade Atlas

However, ASEAN's share in the total amount imported by Brazil was merely 3.7% in 2010. There is a viewpoint that the growth rate of the trade may not be overestimated, but as discussed in the Chapter 2, Section 1, the ratio of trade volume / GDP is larger than those of EU and NAFTA. It cannot be denied that the trade relation between MERCOSUR and ASEAN is becoming closer.

Brazil exported primary products to ASEAN and imported industrial products from ASEAN (Table 2-2-1-12). This means that Brazil works as a material supply source for ASEAN.

Table 2-2-1-12 Trade amount of Brazil and ASEAN (2010)

Brazil's export commodities to ASEAN	US$100 million	ASEAN's export commodities to Brazil	US$100 million
Raw sugar	9.0	Electric equipment and parts	18.0
Food Waste	8.1	Machinery and parts	11.0
Iron and Steel	7.6	Rubber	10.0
Iron ore	7.1	Automobile and parts	3.8
Petroleum oil and Bituminous oil	5.3	Fats and Oils	3.2
Soy bean	4.5	Manmade long-fiber	3.0
Cereals	3.8	Mineral fuel	2.5
Meat	2.9	Foot wear	2.2
Cotton and Yam Fabric	2.8	Manmade Filaments	1.4
Tobacco	1.8	Plastics	1.3

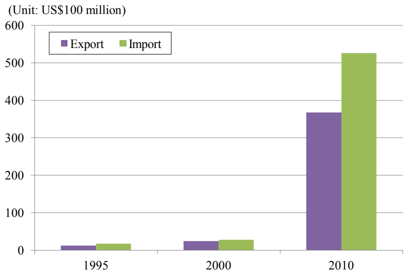
Sources: World Trade Atlas

(B) China

Examining the trade between MERCOSUR and China, the amount imported from China to MERCOSUR was US$2.42 billion and the amount exported to China was US$7.17 billion in 2000. In

2010, the amount imported from China reached US$36.76 billion and that of to China US$52.63 billion. It shows almost 2 digits increase. In this deepening trade relation, the import from China has been rapidly increasing though MERCOSUR still keeps the trade surplus (Figure 2-2-1-13). At the time of 1995, the top 10 commodities imported from China included toys, clothing and footwear, but in 2010, as shown in Table 2-2-1-14, the high ranked commodities were electric instruments and parts, optical instrument, photographic equipment and automobile, etc. The export and import commodities seem to be higher amount of processing and high value added products (however, toys, clothing and footwear were placed at 14th (US$580 million), 15th (US$560 million) and 18th (US$40 million) positions respectively).

Figure 2-2-1-13 Transition of China's trade with MERCOSUR (1995, 2000 and 2010)



Sources: Global Trade Atlas

Commodities exported from MERCOSUR to China were primary products such as iron ore, soy beans, crude oil, wood pulp, fat and oil, steel, meat, raw sugar, tobacco, untreated hide (except fur) and leather (Table 2-2-1-14).

Table 2-2-1-14 Trade amount of China and MERCOSUR (2010)

Commodities exported from China to MERCOSUR	US$100 million	Commodities exported from MERCOSUR to China	US$100 million
Electric equipment and parts	81.9	Iron ore	190.1
Machinery and parts	78.1	Soy bean	137.3
Optical instruments and Photographic equipment	21.3	Crude oil	103.5
Automobile and parts	19.0	Woodpulp	19.5
Organic chemicals	18.0	Fats and Oils	11.5
Iron and Steel	12.4	Iron and Steel	8.9
Iron and Steel products	9.7	Meat	8.2
Plastics and products	7.4	Hides and Skins	8.0
Leather products	7.2	Raw sugar	5.0
Knit, Crocheted Fabrics	7.1	Tobacco	3.7

Sources: World Trade Atlas

(C) NAFTA

The trade with NAFTA is examined by using the trade between Brazil and NAFTA as an example.

NAFTA had been the largest export market for Brazil before the United States lost its top position to China in 2008, but in case of import, the United State still retained its top ranked position, though the import from China has been closer. The trade with NAFTA still has primary importance for Brazil. Specifically, it has a trade pattern in which Brazil imports machine and parts, electric instrument and parts, automobile, organic chemicals and crude oil from the United States, and Brazil exports the final goods as well as primary products to the United States. On the other hand, NAFTA exports the intermediate and final goods, such as machine and parts, aircraft, automobile, plastics and parts to Brazil.

As discussed in Chapter 2, Section 1, NAFTA and MERCOSUR have been close in their relationship, but the trade amount in 2000 was 2.3 times greater compared with that of 2008. The rate of increase in the trade volume is not so large (Table 2-2-1-15).

Table 2-2-1-15 Trade amount of Brazil and NAFTA (2010)

Commodities exported from Brazil to NAFTA	US$100 million	Commodities exported from NAFTA to Brazil	US$100 million
Crude oil	44.7	Machinery and parts	65.3
Machinery and parts	30.4	Petroleum oil and bituminous oil	51.2
Iron and Steel	19.1	Electric equipment and parts	25.9
Automobile and parts	14.4	Organic chemicals	23.5
Coffee	12.3	Automobile	23.5
Rare earth metal	9.8	Plastics and products	19.8
Organic chemicals	9.1	Optical instruments and photographic equipment	17.6
Electric equipment and parts	8.9	Pharmaceutical products	16.6
Woodpulp	8.5	Aircraft	11.7
Rubber	6.9	Fertilizer	9.6

Sources: World Trade Atlas

(D) EU

Examining the trade relation between MERCOSUR and EU, the amount exported from MERCOSUR to EU was US$23.4 billion in 2000, and this accounted for 2.8% of the total EU's import amount, ranked 8th as importers (amount exported from EU was US$24.8 billion, which accounted for 3.2% of EU's export volume , ranked 5th as exporters). However, the rate of increase in the trade amount registered 2.7 times increase in a period from 2000 to 2008. The rate of increase is less than those of China – MERCOSUR (13.7 times increase) and ASEAN – MERCOSUR (5.1 times increase).

The amount was US$63.0 billion in 2010 and it accounted for 3.2 % of EU's import or it ranked 7th (export from EU was US$57.4 billion and accounted for 3.2% of EU's export or ranked 6th). Most of the import from MERCOSUR was primary products such as iron ore, prepared feeding stuff, crude oil and soy beans (Table 2-2-1-16).

Table 2-2-1-16 Trade amount of EU and MERCOSUR (2010)

Commodities exported from EU to MERCOSUR	US$100 million	Commodities exported from MERCOSUR to EU	US$100 million
Machinery and parts	131.6	Iron ore	94.8
Automobile and parts	66.1	Food Waste	83.2
Electric equipment and parts	54.7	Crud oil	68.0
Medical supply	42.4	Soy bean	42.1
Organic chemicals	31.8	Woodpulp	29.4
Optical instrument and photographic equipment	25.3	Coffee	28.6
Plastics	20.2	Meat	23.2
Aircraft	19.2	Machinery and parts	18.9
Petroleum oil and bituminous oil	18.5	Chemical industry products	15.6
Chemical industry products	16.2	Fruits and nuts for edible use	15.6

Sources: World Trade Atlas

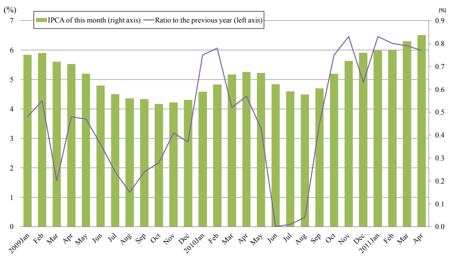
Commodities exported from EU to MERCOSUR are mostly automobile, electric machinery, and intermediate goods such as organic chemicals and plastics. In a peculiar case, MERCOSUR exported aircrafts (US$1,230 million, and ranked 13th) to EU and EU exported aircrafts (US$1,920 million, ranked 8th) though they did not occupy any place within top 10. Another case was the automobile (1,330 million) exports to EU, which occupied the 12th place. Thus, MERCOSUR is a material supply base for EU in the trade relation between MERCOSUR and EU, but competitive situations may be emerging in some parts of the trade relation.

2. Movement of economy and trade in Brazil (including Argentina)

(1) Brazil's standing from a viewpoint of the monetary affairs

Examining the inflation, Indice Nacional de Precos ao Consumidor Amplo (IPCA) recorded 0.77% in April 2011 with an annualized rate of 6.51%. This exceeded 4.5% plus/minus 2% of the nation's policy target (Figure 2-2-2-1). Immediately before that, Central Bank of Brazil increased the policy interest rate by 0.25% to 12% in April. On the other hand, the raise in interest-rate caused inflow of speculation money from overseas accounting for high value of the Real. The Central Bank announced a restrictive measure to introduce a compulsory deposit system to banking institutions, which had a position to sell a large amount of dollar[3] on January 6. In case, a banking institution has US$3 billion or its dollar selling position exceeding its capital size, 60% of the dollar should be deposited compulsorily. The measure was enforced on April 4. Also, a measure to restrict the high value of Real has been taken by raising the tax rate of Imposto Operacoes Financeiras (IOF), which has been imposed on exchange dealing, securities investment and loan. The future effect should be noted.

Figure 2-2-2-1 Brazil's inflation index (Indice Nacional de Precos ao Consumidor Amplo (IPCA)) (Ratio of this month to the previous year)

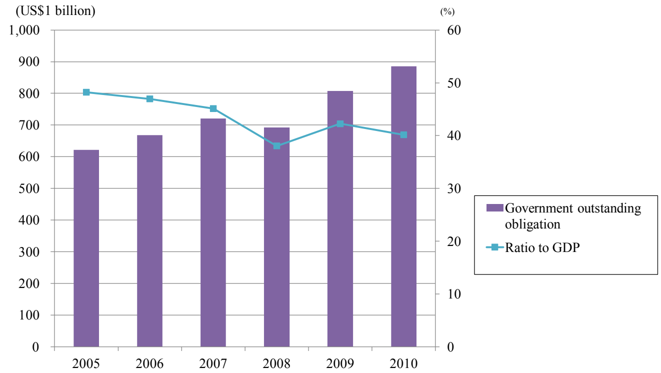


Sources: Central Bank of Brazil; Brazil Geographic and Statistics Board

3 This is the Real buying Dollar selling position here.

Examining the financial policy, Financial Minister Mantega said, "new expenditure shall not be created" in 2011. A target has been set to reduce the rate of debt to GDP from present 41% to 30% in 2014. The background to this is the shrinking primary balance. It became 2.78% in December 2010, which was less than 3.1 % of the initially planned. However, the rate of government debt to GDP of 41% is not a level to cause a debt crisis. There may be little possibility that Brazil lapses into the debt crisis as before (Figure 2-2-2-2). Draft budget of this year shows various scale-downs including reduction of infrastructure investment based on the growth accelerating strategy (R$3.4 billion) and addressing the reduction in public servants' salaries. Additionally, it plans to reduce R$50 billion (US$30 billion) which is expected to contribute restoring the fiscal health.

Figure 2-2-2-2 Brazil's government outstanding obligation and its ratio to GDP (net)

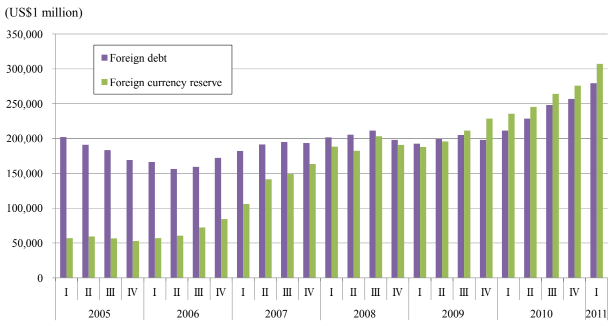


Notes: Amount in 2010 is estimated. Exchange rate is R$1 = US$0.6 (Average from November 24, 2010 to May 23, 2011. Round to the hundredth)
Sources: IMF "World Economic Outlook Database April 2011"

Brazil is currently a net creditor country externally (Figure 2-2-2-3), and the rating agency certifies Brazil's foreign currency denominated national bond as investment grade[4]. This also may reinforce the conditions mentioned above.

[4] Moody's judged as Baa3, Standard & Poor's judged as BBB- and Fitch judged as BBB- (all of them are investment grade), but Fitch raised one notch and made it BBB from April, and Moody's raised one notch and marked it Baa2 in June.

Figure 2-2-2-3 Transition of Brazil's foreign debt and foreign currency reserve



Sources: Central Bank of Brazil; CEIC Database

However, travel expenditure has been increased by the rise of consumer confidence due to improved unemployment rate from 6.8% in 2009 to 5.9%. Remittance from foreign companies to their home countries had increased due to solid results supported by increased domestic demand. Under these conditions, the size of income deficit / service balance increased over the past several years. The pattern is to cover the loss by a strong economy and direct domestic investments attracted by the high interest rate. The direct domestic investment declined in 2009, but recovered in 2010 to the level of 2008 (Table 2-2-2-4). On the other hand, attention is needed for the overheated economy and inflation, which may be caused by further inflow of foreign money attracted by such conditions as high interest rate and better investment grading. IMF[5] has pointed out that matters such as inflation, expansion of credit (increase in credit), dependency on foreign capital and current account deficit have led economies of Latin American countries including Brazil into a difficult position. (However, it has also been pointed out that the monetary system has been healthy). Additionally, it has been pointed out that, external factors like rising of United States' interest-rate may cause the flight of capital[6].

Table 2-2-2-4 Transition of Brazil's current account and domestic direct investment

	2006	2007	2008	2009	2010
Current account	136	16	△282	△243	△473
Trade balance	465	400	248	253	203
Services and income b	△371	△425	△573	△529	△704
Current-unilateral trar	43	40	42	33	28
Foreign direct investm	188	346	451	259	484

Sources: Central Bank of Brazil; ECLAC (UN Economic Commission for Latin America and the Caribbean); CEIC Database, Unit: US$100 million

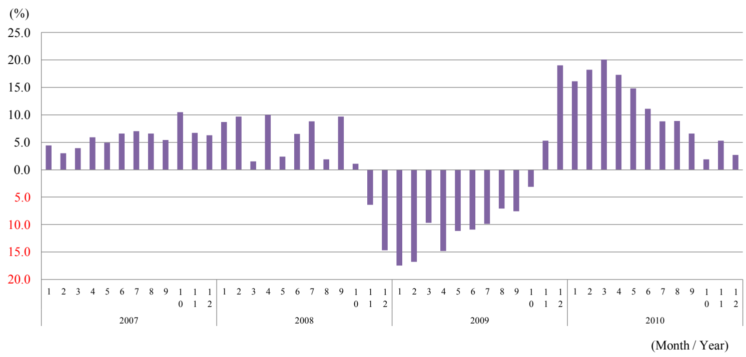
5 IMF website is http://www.imf.org/external/np/tr/2011/tr041511a.htm
6 IMF website is http://www.imf.org/external/pubs/ft/reo/2011/whd/eng/wreo0411.htm

(2) Brazil, as seen from real conditions

(A) Industrial production index

The industrial production index significantly declined in 2009 being affected by the world economic crisis, but recovered at the beginning of 2010. However, the rate of growth was brisk but with a downward tendency since the middle of 2010 (Figure 2-2-2-5). The raising of interest-rate by the Central Bank to control overheated economy and inflation in 2011 may accelerate this downward tendency.

Figure 2-2-2-5 Brazil's industrial production index



Sources: Cabinet Office "Overseas Economic Data"

(B) Automobile sales

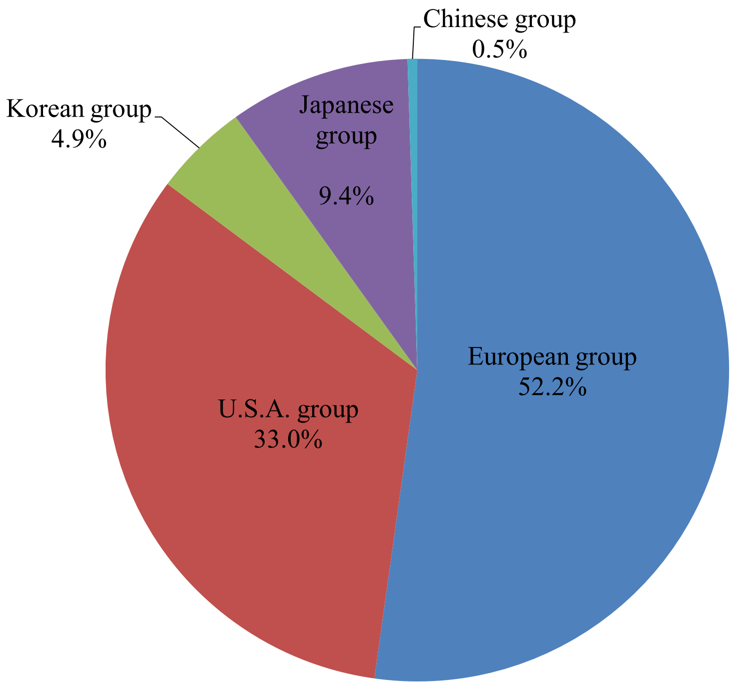
As mentioned in Chapter 1, Section 1, the number of automobiles sold in Brazil in 2010 reached a record high of 3,510,000 units. This was supported by active demand[7] (increase in the middle class income group). Getting ahead of Germany, Brazil ranked 4th in the world after China, the United States and Japan. The six companies from Europe and the United States accounted for 80% of the sales.

Japanese companies operated in Brazil for a long time and accounted for 9.4% of the share of sales. However, Korea, a latecomer, entered the import and sales markets and achieved 4.9% share by succeeding in the advertisement strategy and being supported by the depreciation of Won against the Real. As a result, the rate of share gained by Korean companies exceeded that of each and every Japanese company (Figure 2-2-2-6). In Brazil, automobiles with displacement of 1000cc or less

[7] Reduction in industrial products tax was implemented for passenger cars until March 2010 and for trucks until December 2010.

accounted for 70% of the total automobile sales in the 2000s. This was due to government's tax incentives and a relatively large population in the low-income group. However, recently sales of automobiles with displacement of 1,300 ~ 2,000cc have been increasing[8] following the expansion of markets. A large part of automobiles sold in Brazil were so-called basic cars, or cars not fully complemented in the past, but recently needs for fully complemented cars have been increasing. This suggests that the demand may increase for Japanese cars with higher quality and durability[9]. Considering the facts that Brazil's population per car was 6.9 persons in 2008 compared with 4 persons in Mexico and 1.7 persons in Japan, Japanese companies may have rooms for competing in the markets with superior quality Japanese cars.

Figure 2-2-2-6 Brazil's automobile sales share (2010)



FOURIN "Monthly Survey Report on World Automobile" March 2011, Copyright FOURIN Inc.

(C) Home electronics (Television)

Brazil adopted terrestrial digital media broadcasting system (ISDB-T system) developed by Japan and entered into a transitional period (the analog broadcasting is scheduled to be terminated in 2016). The LCD televisions are becoming popular due to terrestrial digital broadcasting of the FIFA World Cup last year. The dissemination is estimated to progress toward the 2014 FIFA World Cup and the 2016 Olympics Game in Brazil. Sizes of hot-selling LCD TVs are changing from 32" to 40" and to 42" and the markets are becoming active backed by the strong economy. Two Korean companies have accounted for approximately 40% of the market share and three European and Japanese companies have shared the rest of the market. Each Japanese company is making every effort to catch up the situation and expand the market share (Figure 2-2-2-7).

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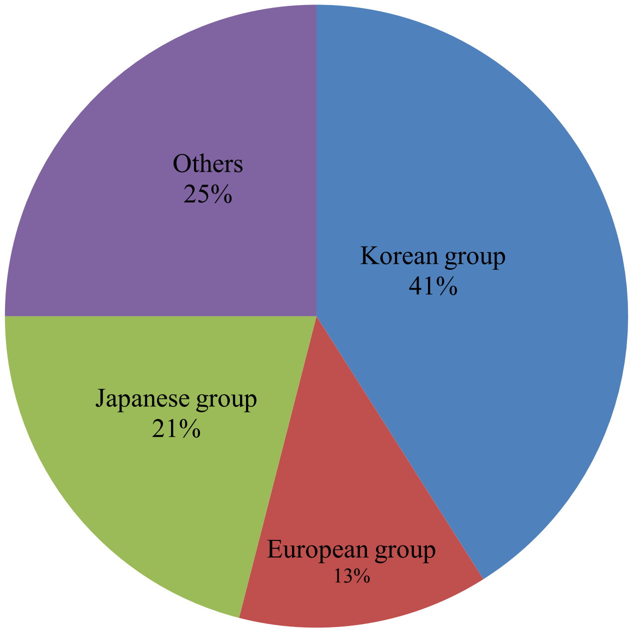
[8] Monthly World Automobile Survey Report (FOURIN), March 2011, Copyright FOURIN, Inc.
[9] Ditto

Figure 2-2-2-7 Brazil's Television sales share (2009)



Sources: Euromonitor International 2010

(D) Motorcycle

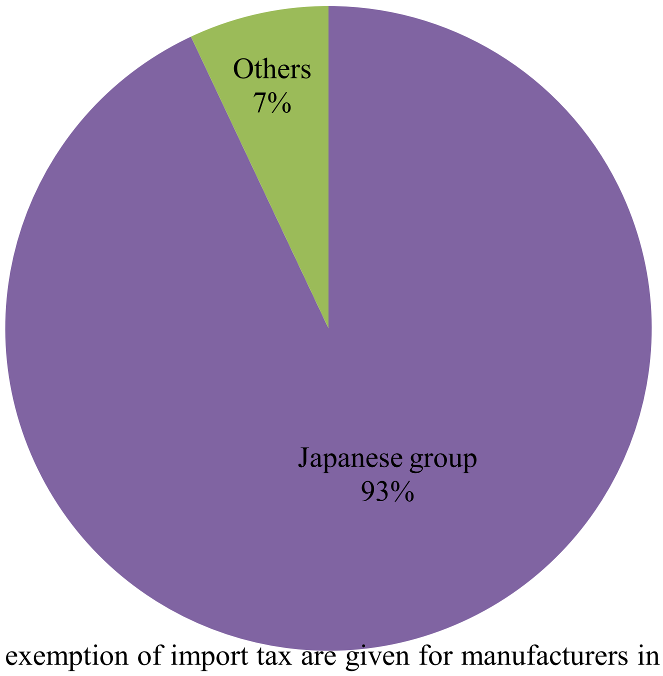
The motorcycle market in Brazil is an example of Japan's success, occupying over 90% share of the market (Figure 2-2-2-8). Japanese manufacturers established the production bases in Manaus, a city located at the middle stream of Amazon River for their production activities. Motorcycles manufactured in Brazil were 2,300,000 units in 2008, but it declined to 1,500,000 units in 2009 being affected by the world economic crisis. Then it recovered to 1,830,000 units in 2010. According to Brazil Motorcycle Manufacturers Association (ABRACICLO), 2,000,000 units are expected to be manufactured in 2011. There should be more scope of selling Japanese motorcycles[10] for reasons, such as Brazil's dissemination rate of motorcycles was 11.7 persons per unit in 2010, growing demand for motorcycles for purposes of hobby and leisure, increasing cruising speed of motorcycles in the southeast area of Brazil where dissemination of cars have progressed; increasing demand for motorcycles with displacement of 250cc or more for a business of delivering documents and parcels which is operated by 150,000 to 300,000 drivers called "motoboy". Classifying the hot-selling motorcycle by the displacement, motorcycles with displacement of 101 to 150cc account for 83% and those of 251cc and over account for 7.4%. The percentage of sales of large sized motorcycles is not high, but number of units sold in Brazil is over 100,000 units[11]. The number is ranked at 4th place after the United States, Italy and Germany (it is approximately 60,000 units in Japan[12]).

[10] "Motorcycle Industry and Market in Brazil" by Mishima, K. JAMAGAGINE, Automobile Manufacturers Association Inc. March 2010, Japan.

[11] Brazil Motorcycle Manufacturers Association (ABRACICLO)

[12] "Motorcycle Industry and Market in Brazil" by Mishima, K. JAMAGAGINE, Automobile Manufacturers Association Inc. March 2010, Japan.

Figure 2-2-2-8
Brazil's motorcycle sales share (2010)



Sources: Brazil Motorcycle Manufacturers Association (ABRACICLO)

Some of tax incentives such as exemption of import tax are given for manufacturers in Manaus[13]. At the same time, however, so called Brazil costs[14] are pointed out. Industrial products manufactured in Manaus are transported by ships to Belem, a city located at the estuary of Amazon, along a waterway of Amazon, due to inadequacy of roads for land transportation (there are two national roads but not insufficiently maintenance) then, they are distributed to Brazilian domestic markets by land transportation (Insurance fee for the land transportation is lower than the cost of transportation by ship due to the large fluctuation of water level between Atlantic and Amazon. The transportation via Belen is a kind of Brazil cost). Other examples of Brazil costs are strict medical checks to hire employees to prevent lawsuit following dismissal and a large number of staffs in indirect departments, which is supposed to be 10 times larger than that of Japan due to complicated taxation system. In addition, wages of workers rise by 6 to 7% annually and the competitiveness in international markets is running out. Furthermore, when FTA is concluded between EU and MERCOSUR, European companies will have no need to locate in Manaus. Future influence of FTA between EU and MERCOSUR should be noted.

(3) Trade between Japan and Brazil

Brazil exports primary products to Japan as they are doing to ASEAN and imports industrial products mainly automobile from Japan. Exceptionally, the products exported to Japan include aircraft

[13] Import tax: by satisfying a condition of PPB (basic process to be done for the manufacturing), 88% reduction of import duty for imported parts, exemption of industrial products tax and export duty; reduction from 9.25% to 3.65% for PIS (Social Integration Plan) and COFINS (Social Insurance Contribution)

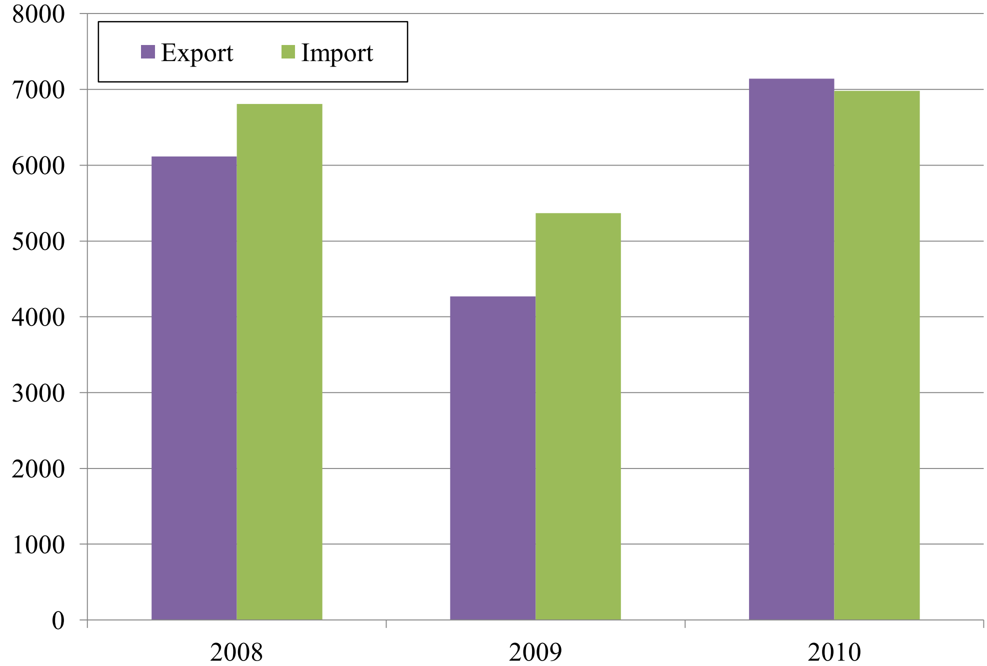
[14] Brazil Japan Chamber of Commerce and Industry website; http://jp.camaradojapao.org.br/brasil-business/advocacia/custo-brasil

manufactured by Empresa Brasileira de Aeronautica S.A. (EMBRAER), Brazil's major aircraft manufacturer. Dominant goods exported from Brazil are iron ore, which account for 46% of the total exported goods to Japan (Figure 2-2-2-9). The trade with Japan had been an import surplus for Brazil, but it has turned to export surplus in 2010 (Figure 2-2-2-10). Exported goods from Japan to Brazil include aircraft parts, which are provided by Japanese manufacturers to EMBRAER.

Table 2-2-2-9 Trade amount of Brazil and Japan (2010)

Commodities exported from Brazil to Japan	US$100 million	Commodities exported from Japan to Brazil	US$100 million
Iron ore	32.7	Automobile, tractor and parts	6.9
Frozen poultry including internal organ	9.1	Passenger car	5.4
Aluminum	4.6	Bearing, gear and parts	3.0
Coffee	3.9	Metric instrument and measurement instrument	2.7
Alloyed metal	3.3	Parts for automobile engine	2.5
Soy bean	1.9	Parts for telephone receiver and transmitter	2.0
Aircraft	1.4	Rolled steel plate	1.8
Woodpulp	1.3	Pump, compressor and parts	1.7
Ethanol	1.3	Copying machine and thermal printer	1.7

Figure 2-2-2-10 Transition of Brazil's trade with Japan



Sources: World Trade Atlas

There are many Japanese ancestries in Brazil and the nation is friendly toward Japan and the natural resources-rich country belongs to the nation compared other BRICs. As shown by its fourth place in the world automobile market last year, the booming Brazilian markets are expected to continue expansion. Hosting Olympic games and FIFA World Cup may further promote the expansion of consumer-electronic markets. The conditions may be important business opportunity for Japanese companies to operate. Although concerns such as inflation and dependency on foreign capital still exist, Brazil, having been rated as an investment grade country with its healthy monetary system, the country is supposed to be different from the Brazil, which had lapsed into the debt crisis in the past. In such conditions, foreign companies and products are actively penetrating the markets and it causes threat to Japanese companies. The government of Japan is also required to create suitable circumstances for activities of the local Japanese companies and for new Japanese companies to expand their business in Brazil.

(4) Improvement of trade and investment circumstances for Japan and Brazil
(Joint Committee for Japan Brazil Trade and Investment Promotion)

The Japan Brazil Trade and Investment Promotion Joint Committee was agreed to be established to develop the increasing closeness between Japan and Brazil, to exchange public and private informal information and to exchange opinions on the improvement of business environment and mutual promotion of trade and investment in 2008. The meeting is to be held at least one time in a year, but actually four meetings have been alternately held since the first meeting in February 2009. Main themes of the discussion were improvement of the business environment and the promotion of trade and investment (Table 2-2-2-11).

Table 2-2-2-11 Major attendants at Japan Brazil Trade Promotion Joint Committee meeting

< Participants >	
Japanese side:	Ministry of Economy, Trade and Industry, Ministry of Foreign Affairs (including Embassy of Japan to Brazil), Ministries and agencies concerned, Japan Economic Federation, Representatives of Japanese companies operating in Brazil (Brazil Japan Chamber of Commerce and Industry), and others
Brazil side:	Ministry of Development, Commerce and Industry, Ministry of Foreign Affairs (including Embassy of Brazil to Japan), Ministries and agencies concerned, Brazil National Industry Union (CNI), representatives of Brazilian companies operating in Japan, and others

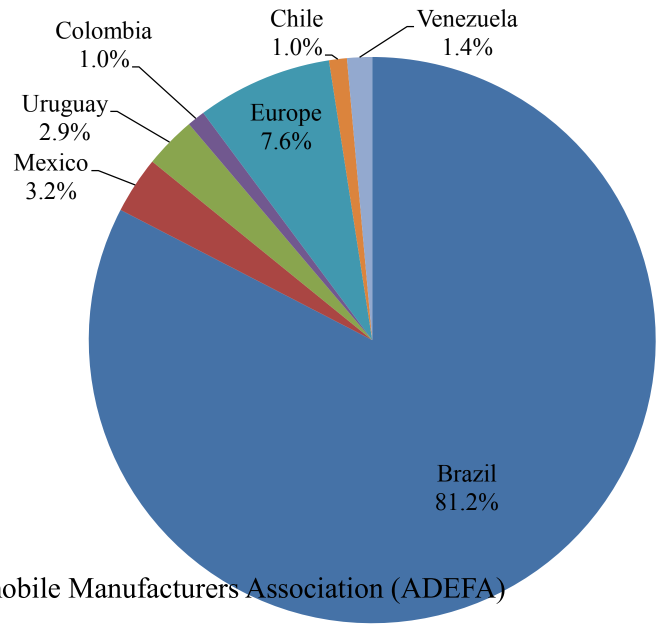
By the way, the fourth meeting of Japan Brazil Trade and Investment Promotion Joint Committee was held in Tokyo in November 2010 and Brazil proposed removal of embargo on exporting pork to Japan and revision of the criteria for pesticide residue of coffee beans, and Japan proposed to remove problems in transfer price taxation system, technology transfer system and to be permitted number of years for visa. Also, matters on mutual interests and possibility of future cooperation were extensively discussed. Thus, public and private alike are actively making efforts to further promote the trade and investment between Japan and Brazil.

(5) Movement of economy and trade in Argentina

Argentina experienced lower rate of annual growth of 0.8% in 2009, but achieved a 9.2% growth in 2010, which exceeded Brazil's 7.5%. Examining the ever-growing automobile industry, number of automobiles sold in Argentina was a record-high of 698,000 units in 2010 (43.3% increase compared with the previous year)[15]. Number of manufactured automobiles also recorded all-time high of 724,023 units (a 41.2% increase compared with the previous year)[16]. Currently, number of automobiles sold in the first quarter of 2011 was 184,971 units (a 20% increase compared with the same quarter of the previous year), and number of manufactured automobiles also continues to increase to 159.486 units (a 28.2% increase compared with same quarter of the previous year)[17].

The rapid expansion of Argentina's automobile production was backed by several factors including existing Brazilian markets, the government's protectionist policy and the government's measures to foster the supporting industry. Especially, the prosperous Brazilian automobile markets substantially contributed to the expansion. Brazil's share accounts for over 80% of the Argentina's automobile export volume. The characteristic of Argentina's automobile export is that most of the destination countries/ regions are neighbor countries such as, Mexico (3.2%), Uruguay (2.9%), Venezuela (1.4%), Colombia (1.0%) and Chile (1.0%) with exception of Europe (7.6%) (Figure 2-2-2-12).

Figure 2-2-2-12 Argentina's partner countries/ regions to export automobile (May 2011)



Sources: Argentina Automobile Manufacturers Association (ADEFA)

In recent years, the government of Argentina has attracted global companies (automobile, electric instruments and others) and induced additional investment from Japan, Europe and the United States

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[15] World Automobile Survey Monthly Report (FOURIN), March 2011, Copyright FOURIN. Inc.

[16] World Automobile Survey Monthly Report (FOURIN), May 2011, Copyright FOURIN. Inc.

[17] Ditto

by tightening the protectionist policy to accelerate the growth of domestic economy.

However, the government of Argentina has two external problems. Firstly, it is the foreign debt issue. Argentina lapsed into economic crisis in 2001, declared default and got behind in payments of external debt. Presently, Argentina has US$8.4 billion Paris Club[18] debt (the debt can be paid back with the US$50 billion foreign currency reserves). Therefore, the debtor countries of Paris Club have withheld giving new export credit to public sectors of Argentina and the export credit associated with the infrastructure building has been restricted.

Secondly, it is the import restriction measure issue. Especially, the problem inconsistent to the WTO rule is "non-automatic import license system[19]" introduced in 2008. When the system was introduced, the subject item was only metal products (elevator and others), but later in December 2010, automobile was included in the restricted subjects. In addition, in January 2011, a new restriction was introduced[20] to permit importation of only 80% of what was imported in the past. Afterward, the subject items continued to increase to reach 600 items as of May 2011.

(6) MERCOSUR and FTA

The "4 + 1" system, by which international negotiation was done as a block, was adopted for FTA of MERCOSUR with countries/ regions outside the region after June 2001 based on the decision No. 32 of the 18th MERCOSUR summit meeting in June 2000. Therefore, each member country of MERCOSUR by itself cannot conclude the FTA with countries/ regions outside the region.

Until now, MERCOSUR signed the FTA framework agreement with Mexico in April 2002; the FTA with Andean Community[21] came into effect in April 2005; and FTA with Israel came into effect in March 2010. Also MERCOSUR signed FTA with Egypt in August 2010 and the negotiation is ongoing with EU and Gulf Corporation Council (GCC).

The negotiation with EU has been started in 1999. Agreement has not been reached on response of EU on agricultural products and that of MERCOSUR on automobile, services and government procurement. The negotiation once broke down in October 2004, but it was agreed to resume at the MERCOSUR and EU summit meeting in May 2010. The five negotiation meetings have been so far held and another is scheduled to be held in July and November 2011. FTA between MEROSUR and EU includes not only goods trade but also services trade, investment, government procurement, protection of intellectual property rights and competition policy. The negotiation is aiming at an unprecedented comprehensive agreement for MERCOSUR.

A joint communiqué was issued at the Korea/ MERCOSUR consultative conference in June 2003 to confirm the intent to conclude FTA. In November 2004, implementation of joint research on the

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18 Conference of major creditor countries to discuss the reschedule for debtor countries which become difficult to pay back; the 19 permanent member countries are Ireland, Italy, UK, Austria, Holland, Canada, Switzerland, Sweden, Spain, Denmark, Germany, Japan, Norway, Finland, France, United States of America, Belgium and Russia.

19 A system obligates to submit application with information such as importers, exporters, prices and quantities of imported goods

20 "Unfair Trade Report 2011" Ministry of Economy, Trade and Industry"

21 Colombia, Peru, Ecuador and Bolivia

possibility to conclude trade agreement was agreed at the Korea/ MERCOSUR summit meeting. Four joint research meetings were held between 2005 and 2006 and a joint communiqué was issued to confirm the merit of FTA as an economic strategy, and completed the joint research on October 31, 2007. The follow-up to joint research has been completed by signing a memorandum to establish a "Korea/ MERCOSUR trade and investment promotion joint conference" in July 2009.

(7) Conclusion

MERCOSUR can be a market with high potential for Japan due to several reasons including the facts that many Japanese ancestries are active in the society especially in Brazil; a massive market with population of 270 million[22] in 2010; over 90% [23]high literacy rate in every country of the group, i.e. 90% in Brazil, 97.7% in Argentina, 95.2% in Venezuela, 94.6% in Paraguay and 97.8% in Uruguay. This proves a higher standard of basic education compared with Asia (for example, literacy rate of India is only 74%[24]). It is important for Japanese companies to establish local companies in member countries of MERCOSUR, which can reduce the customs duties in trade between the member countries to enter into the markets and enjoy the profits before the conclusion of FTA. Although the percentage of trade in Japan's total trade amount is presently not so high compared with other major trade partners, it may be important to further strengthen the trade and investment relation with MERCOSUR, which has great market potentials.

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22 United Nations (2010), "World Population Prospects: The 2010 Revision"
23 UNESCO, "Statistics Data Centre"
24 Ministry of Foreign Affairs website; http://www.mofa.go.jp/mofaj/india/data.html