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A Free Trade Area of the Americas: Status of Negotiations and Major Policy Issues

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Summary

At the second Summit of the Americas in Santiago, Chile (April 1998), 34 Western Hemisphere nations agreed to initiate formal negotiations to create a Free Trade Area of the Americas (FTAA) by 2005. The process so far has led to two draft texts, the second completed for the November 1, 2002 trade ministerial in Quito, Ecuador. The many sections of “bracketed” text indicate that there are still significant differences to be worked out. Although implementing legislation is not anticipated until the next Congress at the earliest, for an FTAA agreement to be signed in January 2005, the 108th Congress, having an expanded oversight authority as defined in the Trade Act of 2002 (P.L. 107-210), will play a crucial role during this last phase of the FTAA negotiations. This report will be updated periodically.

Background and Status of Negotiations

Over the past two decades, trade liberalization and broader economic policy reform in Latin America have raised the prospect of a previously unlikely idea – a Free Trade Area of the Americas (FTAA) involving 34 nations of the Western Hemisphere. Latin America’s approach to freer trade, referred to as “open regionalism,” has involved the creation of sub-regional agreements, some of which are open to new members and whose members remain free to pursue other agreements. Examples include: the North American Free Trade Agreement (NAFTA); the Southern Common Market (Mercado Comun del Sur – Mercosur); the Andean Community (AC); and the Central America Common Market (CACM). These arrangements, along with numerous bilateral agreements and unilateral trade liberalization decisions, have reduced average tariff rates in Latin America from over 40% in the mid-1980s to under 12% by 2000, and doubled trade openness, as measured by imports rising from 10% to 20% of gross domestic product (GDP).¹

¹ Inter-American Development Bank. *Integration and Trade in the Americas*. Washington, D.C. December 2000, pp. 7 and 10.

Many see the FTAA as the next important step for Latin American trade opening and an essential element of an export-led development strategy. Trade-related development, however, requires more than simple export growth. It is through access to larger export markets, higher quality, lower-priced capital goods, and foreign capital that economies can develop manufacturing bases to diversify export earnings away from dependence on price-volatile commodity trade. For example, Latin America's trade has grown faster than the world average over the last decade, yet these countries have been slow to diversify their export base into manufactured goods, particularly to markets outside the region. The exceptions are Mexico and Central America, which have experienced export-diversifying trade creation by participating in closer trade and investment arrangements with the United States. Also, the United States is Brazil's largest market for value-added manufactured products. FTAA advocates argue that broader and deeper regional integration that includes the U.S. market could spur diversified export development in many other Latin American countries, as well.²

Despite the benefits of Latin America's trade liberalization, the multitude of free trade agreements (FTAs) that "open regionalism" has spawned can also lead to inefficient and discriminatory trade. The impetus to correct this situation, combined with the conviction that trade liberalization is a cornerstone for reform and development, has generated widespread support for the FTAA. This includes the United States, which acknowledges its growing trade relationship with Latin America, and the potential for the FTAA to support broader U.S. goals in the region such as promoting democracy, regional security, and drug interdiction efforts. An FTAA is also expected to reduce barriers to trade region wide, allowing all countries to trade and invest more with each other under the same rules. Defining those "rules," however, is no small task.

Writing the FTAA agreement falls to nine negotiating groups responsible for: market access; agriculture; investment; services; government procurement; intellectual property rights; subsidies, antidumping, and countervailing duties; competition policy; and dispute settlement. Each group is chaired by a different country and the overall process is directed by the Trade Negotiations Committee (TNC). The TNC chair has rotated every 18 months or following a trade ministerial meeting, as have chairs of the various negotiating committees. In addition, there is a consultative group on smaller economies, a committee on civil society to provide input from non-government parties (labor, academia, environmental groups), a technical committee on institutional issues, and a joint government-private sector committee of experts on electronic commerce. Draft FTAA texts reflect the input of all countries, and in some cases groups of countries such as Mercosur, with "bracketed text" reflecting areas of disagreement. In an unprecedented nod to transparency in the trade negotiating process, the draft texts are being released upon completion in all four official languages.³

Since 1994, there have been three summits and seven trade ministerial meetings. Trade ministers approved the first draft of the FTAA at the April 5-7, 2001 ministerial in Buenos Aires and it was adopted by the countries at the Quebec City Summit three weeks

² Ibid., pp. 12-15 and Weintraub, Sidney. *Development and Democracy in the Southern Cone*. Center for Strategic and International Studies, Washington, D.C., February 2000. pp. 12-13.

³ See: [<http://www.ustr.gov/regions/whemisphere/ftaa.shtml>] and [<http://www.ftaa-alca.org>].

later.⁴ Additional goals were achieved at the Quito ministerial in November 2002: 1) the second draft of the FTAA agreement was approved and released; 2) Brazil and the United States became co-chairs of the TNC and will guide the negotiating process through its final phase to expected completion in January 2005; 3) a new Hemispheric Cooperation Program (HCP) was established to develop resources to help small countries “strengthen their capacity to implement and participate fully in the FTAA;” 4) a time line was established for the critical market access negotiations; and 5) the final rotation of chairs for the various negotiating groups was completed. The TNC will meet in April 2003 in Trinidad and Tobago and the eighth (next) FTAA ministerial meeting will convene in Miami, Florida in the fourth quarter of 2003; the ninth is scheduled for the following year in Brazil.

The most important recent milestone was the initiation of detailed market access negotiations involving five separate negotiating groups: market access; agriculture; services; investment; and government procurement. Agriculture and the market access groups were given instructions to coordinate their efforts in developing guidelines and chapter revisions, and final revised offers for all market access issues are due by July 15, 2003. The ministerial declaration also formally affirmed that discussions on agriculture, a critical and sensitive topic for most countries, will have to be done with an eye on parallel discussions being undertaken by the World Trade Organization (WTO). The WTO deadline for agriculture negotiations is also set for January 2005.

Major Policy Issues

The FTAA involves a commitment to consider a broad trade policy agenda, and although there is much work to be done, major milestones were passed in 2002. First, when the U.S. Congress passed trade promotion authority (TPA) as part of the Trade Act of 2002 (P.L. 107-210), it removed one major barrier to the FTAA’s completion, particularly from the Latin American perspective. This provided the Bush Administration with guidance on trade negotiations, which if followed, should improve chances that a final agreement will win congressional approval under expedited procedures. To begin fulfilling the new congressional consultation requirements defined in the TPA statute, the USTR’s office formally notified Congress on October 4, 2002 of the Bush Administration’s FTAA negotiation objectives.

Second, the election of Luiz Inacio “Lula” da Silva as President of Brazil settled another important political question given that Brazil will be a key player on many of the issues that must be resolved. Third, the FTAA negotiations entered their final phase after the Quito Ministerial. However, much still lies ahead and if an agreement is to be reached by 2005, which is still uncertain in the minds of many representing some of the smaller Caribbean countries as well as Brazil, the most difficult challenges will have to be addressed during the 108th Congress. The major policy issues are outlined below.

Market Access and Trade Remedy Issues. The negotiating committee on market access faces one of the most difficult challenges, particularly given that the two

⁴ Summits of the Americas took place in Miami (1994), Santiago (1998), and Quebec City (2001). Trade ministerial meetings were hosted in Denver (1995), Cartagena (1996), Belo Horizonte (1997), San Jose (1998), Toronto (1999), Buenos Aires (2001), and Quito (2002).

largest regional economies, Brazil and the United States, have different priorities. The United States, along with Canada, has the lowest average tariff rate in the Western Hemisphere of 4.5%.⁵ But Brazil and other countries argue that many of their exports are subject to U.S. tariff rate quotas (TRQs) and their related high peak tariffs, as well as countervailing duty and antidumping actions. Brazil, by contrast, has the second highest average regional tariff rate of 14.3%, but much lower peak tariff rates. The United States has focused its negotiation position on reducing overall tariff rates as the primary goal in market access discussion.

Latin American countries, by contrast, are pressing to address U.S. trade remedy laws, domestic support for farmers, and peak tariff rates, with Brazil specifically focused on opening the U.S. market further to its agricultural, steel, and textile exports. This raises at least two questions. First, will Brazil and others agree to resolve issues strictly related to market access negotiations independently of trade remedy issues? Second, is there a willingness, especially by the United States, to negotiate trade remedy provisions beyond WTO guidelines, or even consider curtailing application under existing laws? Although viewed as trade and production distorting from an economic perspective, trade remedies are well entrenched and widely supported public policies. In March 2002, the Bush Administration tested both domestic and international sensibilities to this issue when it increased quotas on various steel imports.

In addition to the market access group, specific instructions were given in Quito to the agriculture negotiating group. For many Latin American countries, agricultural exporting is critical for their economic well being and they consider tackling U.S. agricultural trade policies, particularly subsidies, central to any discussion on market access. Many agricultural interest groups in the United States have made clear, however, that they are uninterested in negotiating an agricultural agreement that does not include Europe, hence the importance of the parallel negotiation with the WTO. Brazil and other countries have cautioned that although WTO agricultural negotiations may be a positive step, the FTAA should not be constrained by the WTO process.⁶ This issue could prove to be a major stumbling block to the January 2005 completion date if it bogs down in either the FTAA or WTO negotiations.

The schedule for market access is another issue currently being debated. This touches on two issues. The first is dealing with so-called sensitive products, or those a country may wish to protect as long as possible by reducing tariffs over a longer period of time. In NAFTA, for example, many agricultural products fell into the longest (15-year) tariff phase-out schedule. Second, the FTAA negotiators have agreed to allow for "differentiated access" or different schedules for countries based on their level of economic development. This is intended to help smaller economies by giving them quicker access to the U.S. market and allowing them more time to phase out their own tariffs. Brazil, as a relatively developed economy, has raised concerns that such a process may effectively make it the last country to have full access to the U.S. market. U.S.

⁵ 1999 unweighted average Most Favored Nation (MFN) applied tariff rates reported in: Inter-American Development Bank, *Integration and Trade in the Americas*, December 2000, p. 125.

⁶ For details on agricultural issues, see: CRS Report RL30935, *Agricultural Trade in the Free Trade Area of the Americas*, by Remy Jurenas.

negotiators have responded that the time frame is under Brazil's control based on its specific market access offers.

Other Trade Barrier Issues. Services trade is another important issue for the United States given its competitive strength in such areas as financial services, transportation, engineering, and technology consulting. Beyond market access, there are issues critical to the United States that will eventually take center stage, if the recently completed U.S.-Chile FTA negotiation is any indication. Intellectual property rights (IPR) and competition policy are among the most important. Intellectual property rights violations have hurt U.S. producers throughout the world and few countries have laws protecting intellectual property to the extent the United States does. Copyright issues and protection of digital products are among the more important issues to resolve. This proved difficult with the Chile bilateral agreement and may also require extensive discussion to change laws in over 30 other countries. Competition policy is another difficult area because of the need to standardize approaches regulating domestic economic activity, although it may prove more easily reconcilable than IPR disagreements.

Labor and Environment Provisions. Another contentious issue is language covering labor and environment provisions. Developing countries have often resisted these provisions, arguing that they should be left to domestic governing authorities or the relevant international organization, may be difficult for developing countries to meet, and can be used for protectionist purposes. Concern from the developed world, on the other hand, is that different standards among trading countries may provide competitive advantages or disadvantages (lower or higher costs to produce). Specifically, the concern goes to ensuring that lower environmental or labor standards in developing countries not become a basis for exploitive, lower-cost exporting, or serve to attract foreign capital investment, and that higher standards, as in the United States, not be challenged as disguised barriers to trade. Environmental advocates also point to the social impact of failure to enforce pollution abatement and resource management laws.

NAFTA set a precedent for including labor and environmental provisions in trade side agreements, an approach also adopted in the 1997 Canada-Chile FTA. Since then, the debate has intensified and turns on where the language should be placed in the agreement, the specificity of the provisions, and how dispute resolution will be handled. One reference point is the U.S.-Jordan FTA, which has incorporated labor and environment provisions into the text of the agreement. The wording emphasizes that each country will be held accountable for enforcing its own laws and that trade sanctions, although not expressly called for, are also not excluded as a possible form of dispute resolution. The U.S. Congress also emphasized this approach in the TPA legislation.

For many in the United States and Latin America, these provisions are too strict. The precise location of labor and environmental language in the FTAA is probably less controversial than other aspects. By contrast, staunch resistance has arisen over the use of trade sanctions as a possible remedy for noncompliance with labor or environmental provisions. In the U.S.-Chile FTA, language offered by the United States reportedly calls for fines to address noncompliance, with the possibility of trade sanctions in cases where the fine is not paid. This solution is considered a compromise because it leaves the final decision on the use of trade sanctions in the hands of the country found to be in noncompliance. It is not clear if this or similar language will work for the FTAA.

Outlook

An FTAA would be a ambitious undertaking under the best of circumstances, but the current economic conditions in Latin America are far from supportive. Latin America is coming off one of its worst years since the early 1980s, with economic growth declining by 1.1% for the region as a whole, and 2003 promising a modest recovery at best. Further, adjusting to the changes inherent in adopting broad-based trade liberalization will require even deeper reform efforts, both political and economic, which are particularly difficult to achieve when economies are struggling. Certain countries face immense challenges. Argentina heads the list with a year-old financial crisis that continues to threaten the country's social and political fabric. High debt levels and a record setting financial bailout of Brazil by the International Monetary Fund (IMF) in 2002 also reinforces lingering doubt over the financial situation in the region's largest economy.⁷ Continued unrest in Colombia over guerrilla and drug activity has created tension both within the country and with its neighbors. Protests and strikes against the Hugo Chavez regime in Venezuela also invite concern over the short-term future of regional cooperation and the prospects for an FTAA.

With Brazil and the United States chairing the executive committee in charge of the negotiations, determining how the process will proceed (what, how, and when issues will be negotiated) may be as important as the negotiation issues themselves. Both countries will push for moving their agenda forward. Negotiating difficulty is compounded by the breadth of social policies attached to the agreement. In addition, in virtually all countries, the politics of trade continue to resuscitate industry and sectoral protectionist arguments, with the United States and Latin American countries having significantly different priorities in some cases. Resolving these differences will likely require a demonstrable concern for addressing adjustment costs through a combination of tough bargaining and strategic compromise, not only at the negotiating table, but in the U.S. Congress and throughout the Western Hemisphere.

Finally, in the United States, a major barrier was removed with passage of TPA, but many Latin Americans still express doubt over the U.S. commitment to a region-wide FTA given decisions in 2002 to expand steel quotas and domestic agricultural subsidies. U.S. pursuit of bilateral agreements with Chile and Central America (and already established agreements with Mexico, the Caribbean and Andean region) appears to reinforce such doubt. Therefore, despite a sense of general support for the FTAA concept, there is still the challenge of gaining timely, broad political acceptance in the United States (and throughout the hemisphere) for a specific agreement. Implementing legislation is not anticipated until the 109th Congress at the earliest, but for an FTAA agreement to be signed in January 2005, the 108th Congress, having an expanded oversight authority as defined in the Trade Act of 2002 (P.L. 107-210), will play an crucial role during the last phase of the FTAA negotiations.

⁷ See: CRS Report No. RL31637, *Spreading Financial Instability in South America*, by J. F. Hornbeck and Martin A. Weiss.