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J. F. Hornbeck
Congressional Research Service

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

J. F. Hornbeck

Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

Summary

In 1994, 34 Western Hemisphere nations met at the first Summit of the Americas, envisioning a plan for a Free Trade Area of the Americas (FTAA) by January 2005. Nine years later, the third draft text of the agreement was presented at the Miami trade ministerial held November 20-21, 2003. Deep differences remain unresolved, however, and, as reflected in the Ministerial Declaration, have taken the FTAA in a new direction. It calls for a two-tier framework comprising a set of “common rights and obligations” for all countries, augmented by voluntary plurilateral arrangements with country benefits related to commitments. A follow-up meeting in Puebla, Mexico was unable to clarify the details of this arrangement and negotiations will continue in late April 2004, when it is hoped that specific commitments will be defined. This report provides background and analysis for Congress on the proposed FTAA and will be updated.

Background and Negotiation Process

For two decades, growing trade liberalization in Latin America has raised the prospect of a previously unrealized idea — a Free Trade Area of the Americas (FTAA) involving 34 nations of the region. Latin America’s trade reform has been christened the “New Regionalism” to reflect the evolution from an “old” system of closed subregional agreements that dominated in the post-war era, to one based on more open and deeper commitments both within and outside the region, and all part of broader policy reform efforts that emerged in the aftermath of the 1980s debt crisis. Examples include the North American Free Trade Agreement (NAFTA), the Southern Common Market (Mercado Común del Sur — Mercosur), and the Central American Common Market (CACM), as revitalized in the 1990s. Combined with unilateral, bilateral, and multilateral efforts, these subregional agreements have fostered trade opening, with average tariff rates in Latin America having fallen from 40% in the mid-1980s to under 12% by 2000.¹

¹ Inter-American Development Bank. *Beyond Borders: The New Regionalism in Latin America. Economic and Social Progress Report*. Washington, D.C. 2002, pp. 25, 32-33, and 62.

Many see an FTAA as the next important step for Latin American trade opening and as an essential element of an export-led development strategy. There are three important aspects to this strategy: 1) increased trade within the Latin American region; 2) increased trade with large markets like the United States; and 3) increased foreign direct investment. Intraregional trade has grown precipitously and is recognized as a key factor in output and productivity growth for the region. Latin America's trade has grown faster than the world average over the last decade, in part due to growth in traditional exports such as agriculture and other commodities. Increasingly, such as in Mexico and Central America, diversification into manufacturing has been a direct result of closer trade and investment ties with the large industrial U.S. market. Therefore, the FTAA raises expectations for many that it will lead to growth in traditional exports as well as promote trade diversification with the help of foreign investment.²

Despite the noted progress in Latin America's trade liberalization, the multitude of free trade agreements (FTAs) that the "New 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 official support for an FTAA, although skeptical attitudes prevail as well. This includes the United States, which acknowledges its growing trade relationship with Latin America, and the potential for an FTAA to support broader U.S. goals in the region such as promoting democracy, regional security, and drug interdiction efforts. But, these goals can be difficult to reconcile with interests of import competing industries, as well as, those of labor and environmental groups.

An FTAA would encourage more trade, in part, because all countries would operate under the same "rules." Writing these "rules," however, is the key challenge and 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 groups. 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 four summits and eight trade ministerial meetings. The first draft of the FTAA was adopted at the Quebec City Summit in 2001 and a second draft was completed at the Quito ministerial in November 2002. At that time, Brazil and the United States became co-chairs of the TNC and were charged with guiding the

² Ibid., pp. 24-29 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>].

negotiating process to its completion. The third draft was completed for the November 2003 FTAA ministerial in Miami (and the January 2004 hemispheric summit in Mexico).⁴

Major Negotiation Issues

The FTAA concept began as a commitment by 34 countries to consider a broad trade policy agenda, which is a challenging task. In essence, U.S. priorities differ from those of key Latin American countries, making a balanced and mutually acceptable agreement difficult to define, as a short review of the negotiating issues suggests.

Market Access and Trade Remedy Issues. Market access is one of the most difficult challenges given that the two largest regional economies, Brazil and the United States, have different priorities. The United States (and Canada) has the lowest average tariff rate in the Western Hemisphere of less than 4%. 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 much lower peak tariff rates, but has the second highest average regional tariff rate of 15% and relies on other trade barriers, as well.⁵ The United States has focused on reducing overall tariff rates as the primary goal in market access discussions, but its specific offers differ significantly from those of Brazil (see next section).

Latin American countries, by contrast, have been 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. Specific instructions were given at the Quito ministerial to make progress on agriculture issues. Agriculture is the most protected sector in most economies and for many Latin American countries, is critical for their economic well being. Historically, it has proven to be among the most difficult areas to liberalize, yet many Latin American countries consider tackling U.S. agricultural trade policies central to any discussion on market access. The United States is open to discussing many agricultural issues, but has also made clear that it will not negotiate domestic agricultural subsidies in a regional pact because it would diminish its multilateral bargaining position on subsidies with the European Community and Japan in the broader World Trade Organization (WTO) talks.⁶

Other Trade Barrier Issues. The United States is also interested in non-goods trade, areas where it has a distinct advantage. Services trade, for example, is a vital issue, including such important sectors as financial services, transportation, engineering, and technology consulting. Intellectual property rights (IPR), government procurement, and competition policy are also critical issues. Intellectual property rights violations have hurt U.S. producers throughout much of Latin America and no country has laws equal to the

⁴ Summits of the Americas took place in Miami (1994), Santiago (1998), Quebec City (2001), and Monterrey (2004). Trade ministerial meetings were hosted in Denver (1995), Cartagena (1996), Belo Horizonte (1997), San Jose (1998), Toronto (1999), Buenos Aires (2001), Quito (2002), and Miami (2003).

⁵ 2000 unweighted average Most Favored Nation (MFN) applied tariff rates reported in: Inter-American Development Bank, *The New Regionalism in Latin America*, p. 62.

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

United States in protecting intellectual property. Copyright issues and protection of digital products are among the more important issues to resolve. This proved difficult to resolve in 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. Many Latin American countries, including Brazil, are reluctant to open up government procurement fully, preferring instead to support domestic industry participation.

Labor and Environment Provisions. Another contentious issue is language covering labor and environment provisions. Developing countries often resist these provisions, arguing that they: 1) should be left to domestic governing authorities or the relevant international organization; 2) may be difficult for developing countries to meet; and, 3) can be used for protectionist purposes. Concern from developed countries is that lower standards among trading countries may provide competitive advantages (lower costs to produce), which should not serve as a basis for exploitive, lower-cost exporting or to attract foreign investment, and that higher (e.g., U.S.) standards 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 environment provisions in trade side agreements. Since then, the debate has intensified and has turned on where the language should be placed in the agreement, the specificity of the provisions, and how dispute resolution will be handled. A key reference point is the U.S.-Jordan FTA, which incorporated labor and environment provisions into the text of the agreement and provided for a single dispute resolution mechanism for both commercial and social issues. The wording emphasizes that each country will be held accountable for enforcing its own laws, will reaffirm its commitments to basic United Nations International Labor Organization (ILO) labor standards, and not diminish its standards as a way to encourage trade and investment opportunities. Trade sanctions, although not expressly called for, were not excluded from the FTA as a possible remedy for noncompliance.

Many in the United States and Latin America found these provisions too strict and resistance arose over the possible use of trade sanctions. The U.S. position, as reflected in FTAs with Chile and Central America, calls for limited “monetary assessments” to address noncompliance, with a recourse to loss of trade benefits as a way to collect unpaid fines, if needed. Labor advocates argue, however, that these provisions step back from the U.S.-Jordan commitments because dispute resolution expressly applies only to upholding domestic labor laws, not reaffirmation of ILO standards nor “non-derogation” from domestic standards.⁷ This issue hinges on one’s interpretation of congressional intent of negotiating objectives, as written in the Trade Promotion Authority (TPA), which the USTR argues it has met in the Chile agreement. The monetary assessment is also questioned as a “meaningful deterrent” for various reasons, which the USTR also disputes. At the November 2003 ministerial, the first labor ministers’ report was

⁷ Report of the Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC). *The U.S.-Chile and U.S.-Singapore Free Trade Agreements*. February 28, 2003. pp. 5-9 and USTR Response to the Labor Advisory Committee (LAC) report on the proposed FTAs with Singapore and Chile. Undated. See: [<http://www.USTR.gov>].

presented, calling for more attention to labor issues and better implementation of labor commitments, but no action was taken.

Outlook: A Two-Tier FTAA?

Over the past year, FTAA negotiators have faced a huge challenge in trying to meet the divergent interests of 34 countries so different in size, economic capability, and political interest. One difficulty is the age-old problem of accommodating politically powerful interest groups that want to protect their special treatment. Given this constraint, and the difficulty smaller countries anticipate in adjusting to freer trade, it seems that some countries may not be ready to accept the obligations of a comprehensive and deep FTAA. These differences have been highlighted in the debate between Brazil and the United States and form the basis for a compromise unveiled in the November 2003 Miami Ministerial Declaration.

A middle ground is emerging that was not initially contemplated based on tension between Brazil and the United States. This began in May 2003 when Brazil challenged three U.S. policy initiatives. First, U.S. pursuit of subregional trade arrangements (NAFTA, the Andean Trade Preference Act (ATPA), the Caribbean Basin Initiative (CBI), and bilateral deals), which Brazil suggests is isolating Mercosur in the context of the FTAA negotiations. Second, U.S. refusal to address agricultural subsidies and antidumping disciplines in the FTAA, which have affected Brazil's key export sectors. Third, the U.S. offer of "differentiated" market access, which Brazil argues gives it the least favorable treatment. Brazil responded with its "Three Track Proposal" requesting the United States: 1) conduct separate market access discussions with Mercosur (the "4+1" arrangement); 2) jettison investment, services, government procurement, and IPR issues along with agricultural subsidies and antidumping (per U.S. wishes) to the Doha WTO round; and 3) include some rules-based issues in the FTAA discussions. The United States rejected this so-called "FTAA lite" proposal and continued to argue for a comprehensive FTAA.

Brazil's strategy rests on two negotiating pillars. Offensively, it wants changes in agriculture market access rules because agribusiness is 25% of its GDP and increasing agricultural exports is a major goal. Also, by ruling out discussion of domestic subsidies in the FTAA, the United States became vulnerable to Brazil's hardline critics.⁸ Equally important to understanding Brazil's trade stand is its defensive position toward opening its less competitive sectors of the economy to developed countries (services, IPR, government procurement, and investment), while prioritizing domestic market development and Mercosur trade. Brazil is also the least dependent of all the Latin American countries on the U.S. market and has no U.S. preferential arrangement at stake to protect, so it has resisted pressure to accept a deeper FTAA or to diminish its expectations for greater U.S. agricultural market access.⁹

⁸ Interestingly, research by the Organization of American States (OAS) suggests eliminating agricultural subsidies would increase FTAA trade very little, whereas a far bigger gain would come from reduction in tariffs. See: Salazar-Xirinachs, José M. *The FTAA and Development Strategies in Latin America and the Caribbean*. OAS Trade Unit. November 2003. p. 7.

⁹ Lorenzo, Fernando and Rosa Osimani. *Negotiations of the Mercosur with the FTAA and the US*. Red de Investigaciones Económicas del Mercosur. Montevideo, Uruguay. July 2003.

The U.S.-Brazil differences were the major factor that determined the outcome of the jointly-authored *Ministerial Declaration*, which defines how the FTAA negotiations will proceed. Although the ministerial declaration reaffirms the commitment to complete a “comprehensive and balanced” agreement by January 2005, it does so in the context of a rather unorthodox compromise. The declaration states that “*countries may assume different levels of commitments...[with a] common set of rights and obligations applicable to all countries...[and may also] choose, within the FTAA, to agree to additional obligations and benefits.*” The additional obligations may be defined in plurilateral negotiations, with a country’s benefits being linked to the obligations it undertakes. The TNC was instructed to define the common set of rights and obligations.

At the Puebla TNC meeting held February 2-6, 2004, negotiators were unable to agree on the core set of rights and obligations. Brazil’s position was unchanged and called for all industrial and agricultural goods to be in the market access provisions, while pressing for elimination of export subsidies and addressing domestic price supports for agricultural goods. It did not want to go beyond WTO commitments for services, IPR, government procurement, or investment. The U.S. priorities were nearly the opposite, calling for the inclusion of the last four topics and limiting market access language to “substantially all” products. The United States agreed to the elimination of export subsidies, but not domestic support for agriculture.

In addition, a group of G-14 countries, led by the United States, made progress on agreeing to what a second tier of obligations in a plurilateral arrangement might include. All the other 13 countries either have, are negotiating, or soon will begin to negotiate an FTA with the United States. Therefore, they may be prepared to accept, to varying degrees, a broader range of obligations similar to those in U.S. bilateral agreements with Chile and Central America, and which may include many trade issues Brazil is currently unwilling to adopt. It is also possible that other plurilateral arrangements involving Brazil and other countries will develop.

Latin America’s New Regionalism is alive and well in the FTAA process. Both Brazil and the United States are courting other countries for their support in the FTAA negotiations and as partners in bilateral or sub-regional agreements (a third approach to a two-tier FTAA). Progress on the FTAA itself, however, still rests with Brazil and the United States finding common ground on the common set of obligations and defining parameters for plurilateral arrangements. An informal meeting held in Buenos Aires on March 9-10, 2004 among 11 FTAA representatives resulted in postponing a second Puebla TNC meeting from March 18-19 to late April 2004 over this very issue.

As the FTAA negotiations continue the trade dynamics of the region are changing. With much of the region heading toward bilateral agreements with the United States, the basic elements of which could also be the basis for an FTAA plurilateral arrangement, Mercosur countries may have to evaluate the welfare tradeoffs of entering a deeper versus a shallower two-tier FTAA, or no FTAA at all. The latter two options may further isolate Mercosur in some respects. For example, regional trade and investment patterns could change significantly based on agreements forming around Mercosur. This picture is still unclear and depends on how the U.S. Congress addresses pending trade agreements and whether there is any progress at the April 2004 Puebla TNC meeting.