

CRS Report for Congress

Received through the CRS Web

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

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 negotiating groups completed a draft agreement in January 2001, which was presented at the third Summit of the Americas held in Quebec City on April 20-22, 2001. President Bush expressed strong support for the FTAA and concrete progress has been made in moving it forward. Yet, differences in priorities among the negotiating countries are still evident, suggesting that the FTAA faces many policy hurdles in both the U.S. Congress and the hemisphere.

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). Latin America has approached freer trade through “open regionalism,” or the creation of sub-regional preferential agreements that remain 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). Along with numerous bilateral agreements, these and unilateral trade liberalization decisions have reduced average tariff rates in Latin America from over 40% in the mid-1980s to under 12% in 1999, and doubled trade openness, as seen in imports rising from 10% to 20% of gross domestic product (GDP).¹

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

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

markets, and more importantly, higher quality, lower-priced imports, that economies develop manufacturing export bases to diversify 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 diversification of exports into manufactured goods has been slow, particularly to extra-regional markets. The exceptions are Mexico and Central America, which by participating in preferential trade arrangements with the United States, have experienced export-diversifying trade creation. FTAA advocates argue that broader and deeper regional integration that includes the U.S. market could spur similar development in other Latin American countries.²

Despite the success of Latin America's "open regionalism" in bringing about trade liberalization, the more than 50 trade agreements that it has spawned throughout the Western Hemisphere may be viewed as inefficient and discriminatory arrangements.³ The impetus to simplify this situation, combined with the belief that trade liberalization is a cornerstone for reform and development, has generated wide support for an FTAA. The United States has led the effort to negotiate an FTAA recognizing its growing trade relationship with Latin America. In addition to economic gains, many view the FTAA as supportive of broader U.S. goals for the region such as promoting democracy, regional security, and drug interdiction efforts. An FTAA could 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.

Progress on the FTAA at first proceeded deliberately, but slowly, in part to focus on administrative and organizational needs, but also because of an overall cautionary attitude. Since 1994, there have been six trade ministerials and three summits.⁴ Writing the agreement falls to nine negotiating groups responsible for: market access; agriculture; investment; services; government procurement; intellectual property rights; subsidies, anti-dumping, 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 rotates every 18 months or following a trade ministerial meeting. Ecuador assumed the TNC chair at the Quebec City Summit in April 2001 and will be followed in October 2002 by a joint appointment of Brazil and the United States. 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), and a joint government-private sector committee of experts on electronic commerce.

In recent years, the FTAA process has picked up momentum. At the November 1999 Toronto ministerial, the negotiating groups set a goal of penning comprehensive draft texts for the nine negotiating areas. These were completed and approved by the trade ministers at the April 5-7, 2001 meeting in Buenos Aires and adopted at the Quebec City Summit

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 For a detailed discussion, see: CRS Report 97-762 E, *A Free Trade Area of the Americas: Toward Integrating Regional Trade Policies*, by J. F. Hornbeck. September 25, 1997.

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), and Buenos Aires (2001).

three weeks later. The drafts reflect the input of all countries, and in some cases groups of countries such as Mercosur, with “bracketed text” reflecting areas that lack consensus. In an unprecedented nod to transparency in the trade negotiating process, the text of the draft has been released in all four official languages.⁵

In addition to the trade agreement language, significant progress has also been made with implementing “business facilitation” measures approved at the Toronto meeting. Ten transparency and eight customs efficiency measures were adopted to improve the flow of trade immediately. These include practices such as setting national codes of conduct for customs officials, creating procedures to expedite express shipments, and linking FTAA country negotiating web sites via the internet, among others. Business facilitation is considered an ongoing goal and important concrete evidence for the business community that the negotiating governments are taking pursuit of “easier” as well as “freer” trade seriously.⁶

Important milestones are scheduled for the year ahead. Negotiation of market access issues, a critical and controversial component of the agreement, will begin on May 15, 2002. A second draft text of the agreement is scheduled for completion by the Seventh Ministerial meeting to be held in Ecuador in October 2002. At that point, the chair of the negotiations will transfer from Ecuador to Brazil and the United States for co-management through the end of the process.

Major Policy Issues

The FTAA includes a commitment to consider a broad trade policy agenda, and although each of the negotiating groups and supporting committees have responsibility for many important issues that must be resolved, a few key areas grouped below headline the debate. Many of these issues present formidable obstacles to consensus building both within the United States and among the 34 countries committed to the FTAA. As such, although the April 2001 trade ministerial and summit meetings shed some light on their eventual resolution, more time will be required for the United States and other delegations to resolve deep-seeded differences.

Trade Barrier Issues. The negotiating committee on market access faces one of the most difficult challenges, particularly given that the two largest regional economies, Brazil and the United States, have differing priorities. The United States, along with Canada, has the lowest average tariff rate in the Western Hemisphere of 4.5%.⁷ Because it has already adjusted to lower tariffs, the United States has emphasized tariff reduction as a priority. Brazil, by contrast, has the second highest average regional tariff rate of 14.3% and has resisted prioritizing tariff discussions over other negotiating areas. In fact, Brazil has expressed concern that a sudden reduction in tariff rates would open the flood gates of U.S. products to Brazil, a issue voiced by many smaller countries, as well.

⁵ See: [<http://www.ustr.gov/regions/whemisphere/ftaa.shtml>] and [<http://www.ftaa-alca.org>].

⁶ Inter-American Development Bank, *Integration and Trade in the Americas*, pp. 52-53 and USTR. *2001 Trade Policy Agenda and 2000 Annual Report*. March 2001. pp. 111-12.

⁷ 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.

Alternatively, Brazil and other Latin American countries are pressing to address U.S. use of trade remedy laws, domestic support for farmers, and peak tariff rates. Brazil has conveyed a strong unwillingness to support an FTAA that ignores these areas. Specifically, Brazil wants the United States to open its markets further to agricultural, steel, and textile exports by reducing or eliminating antidumping and countervailing duty actions, and lowering peak tariffs on steel, orange juice, and shoes among other of Brazil's chief exports. This raises the question of whether countries, especially the United States, are willing 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. The United States has expressed a preference for dealing with these issues at the WTO level, and actually inflamed the issue with the March 2002 Bush Administration decision to impose quotas on various steel imports, which engendered a critical response from Brazil and others.

Labor and Environment Provisions. Another contentious issue is language covering labor and environment provisions. Many developing countries are reluctant to negotiate these issues based on convictions that: 1) they are not core trade-related provisions; 2) they should be left to domestic governing authorities or relevant international bodies, such as the United Nations International Labor Organization (ILO); 3) it is unreasonable to expect developing countries to meet developed country labor and environmental standards; and 4) U.S. proposals on labor and environmental provisions amount to protectionism.

Concern from the developed world, on the other hand, is that varying levels of 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 with the expectation of doing so in the future. Environmental advocates also point to the social impact of failure to enforce pollution abatement and resource management laws, particularly in countries dependent on natural resource exports.

NAFTA set a precedent for including labor and environmental provisions in trade side agreements, an approach also adopted in the 1997 Canada-Chile free trade agreement (FTA). At the third Summit of the Americas, President Bush and the other hemispheric leaders made clear their support for dealing with labor and environmental issues. The Declaration of Quebec City states:

We commit our governments to strengthen environmental protection and sustainable use of natural resources with a view to ensuring a balance among economic development, social development and the protection of the environment...and...we promote compliance with internationally recognized core labor standards as embodied in the International Labor Organization (ILO) Declaration on Fundamental Principles and Rights at Work.

Despite this apparent movement toward compromise, the debate has intensified and turned specifically to 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 proposed U.S.-Jordan FTA, which has incorporated labor and environment provisions into the text of the FTA rather than relegating them to side agreements. In addition, wording

of the agreement emphasizes that each country will be held accountable for enforcing its own labor and environmental standards (a key goal of the NAFTA side agreements) and that trade sanctions, although not expressly called for, are also not excluded as a possible form of dispute resolution.

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. One option is to place the language in the body of the text, although Chile, among others, is making the case for side agreements. By contrast, staunch resistance has arisen over the use of trade sanctions as a possible remedy for violating labor or environmental provisions. Chile is already on record as opposing the use of trade sanctions for what it considers non-trade issues in either a bilateral FTA with the United States or the FTAA. Other Latin American countries, including Brazil, agree and the Instructions to the Negotiating Groups in the Ministerial Declaration of Buenos Aires state: "Most Ministers recognize that the issue of environment and labor should not be utilized as conditionalities nor subject to disciplines, the non compliance of which can be subject to trade restrictions or sanctions." President Bush has come out against the use of trade sanctions, an issue also splitting the U.S. Congress.

One option drawing attention is the approach taken in the Canada-Chile FTA (borrowed from NAFTA), which relies on a "monetary enforcement assessment,"⁸ but this too is facing resistance as ineffective, with some arguing for a flexible approach that may include, but not specifically require, trade sanctions. The official U.S. position, as outlined in the USTR negotiating document, reflects an underlying point that incorporating labor and environmental concerns into trade agreements now appears unavoidable, but nonetheless, should not be done in such a way as to encourage protectionism. Finding a specific middle ground among countries in varying levels of development with diverse economic characteristics, and among parties in the United States with diverse political interests, will take carefully constructed language.⁹

Trade Promotion Authority and the FTAA. President Bush has expressed a strong desire for Congress to pass a Trade Promotion Authority (TPA) bill as soon as possible to strengthen the U.S. hand in negotiations. To date, bilateral agreements have been signed with the expectation that congressional approval could be won even without TPA, which allows for only an up or down vote on the trade implementing legislation (no amendments). In the case of a large regional agreement such as the FTAA, many observers, including most Latin American countries, consider it unlikely that such an agreement would be able to obtain unamended congressional approval.

Latin American countries have expressed a strong desire for President Bush to be given TPA, not only as a necessary trade negotiating tool, but to signal that the United States is serious about undertaking the final negotiating stages of an FTAA. TPA is also important because it will be the legislation that provides the precise language defining the parameters for negotiation of the issues discussed above. For many observers, TPA is

⁸ The maximum assess is capped at \$10 million to be paid into a fund used to improve labor or environmental law enforcement "in the country complained against, consistent with its laws."

⁹ For a more detailed discussion, see: CRS Report RS20909. *Trade Agreements: A Pro/Con Analysis of Including Core Labor Standards*, by Gary J. Wells.

perhaps the key statement of U.S. political willingness to move forward seriously on the FTAA, and free trade negotiations in general.

Outlook

Creation of an FTAA would be a monumental undertaking under the best of circumstances, but currently there are a number of seemingly intransigent positions on the negotiating table. 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 in the U.S. Congress, but throughout the Western Hemisphere.

Broader problems may also potentially delay movement on the FTAA. For the Latin American countries, adjusting to the changes inherent in adopting broad-based trade liberalization will require that reform efforts (political and economic) continue and deepen. Regional “flare ups” in many countries challenge this trend. Argentina heads the list with a financial crisis that threatens the country’s social and political fabric. Continued unrest in Colombia over guerrilla and drug activity has created tension both within the country and with its neighbors. Protests against the populist regime and economic downturn in Venezuela also invite concern over the short-term future of regional cooperation. These and other developments add to the level of uncertainty in moving forward with the FTAA process, although most Latin American leaders appear to support it.

In the United States, many argue that a stalemate in moving TPA legislation could be viewed as equivalent to a solid vote against freer trade. Also, the recent U.S. steel quota decision has become an internationally divisive issue, heightening concerns over the U.S. commitment to trade liberalization. Such a perception could complicate FTAA negotiations further, particularly as Brazil and the United States move toward co-chairing the process. In fact, it may become more difficult to coax concessions in trade barrier reductions from either country if a trade conflict comes to dominate the discussions. Should TPA legislation remain at an impasse, Congress and the Bush Administration are faced with the prospect that an FTAA may not be achievable within the anticipated time frame and that continuing the route to freer trade via bilateral agreements is the easier course. Therefore, if the FTAA is to gain the necessary political support, it must become clear to the multitude of interest groups throughout the hemisphere that it indeed is a region-wide, mutually beneficial agreement.