

---

## The FTAA: Objectives and National Interests

Up to this point, the analysis of the hemisphere-wide free trade initiative has focused on the economic and political conditions under which the FTAA negotiations are taking place. This chapter now discusses the scope and coverage of the trade talks and the key interests of the participating countries.

At the outset, it is important to emphasize that the FTAA will not be a substitute for the current regional arrangements in the hemisphere. Those pacts will coexist and complement the hemispheric agreement; indeed, the readiness of Latin American and Caribbean countries depends importantly on the deepening of reforms undertaken pursuant to those regional arrangements, and thus the success of those integration pacts is integral to the success of the FTAA. In some instances, regional trading rules may be changed to conform to the hemisphere-wide standards (which would help firms reduce transaction costs); in other cases where regional trade obligations go beyond those in the FTAA, the regional rules may prevail.

The Miami Summit committed to an ambitious timetable for concluding negotiations on the FTAA “no later than 2005”, and achieving “concrete progress toward the attainment of this objective” by the end of this century (Miami Summit Declaration). The Quebec Summit reconfirmed that talks would be completed by January 2005 and added a target implementation date of no later than December 2005. As of early 2001, FTAA participants had agreed on a number of business facilitation measures (covering visas, customs clearance procedures, and electronic data interchange systems) that already are being implemented (Salazar-Xirinachs

2001, 287–88). In addition, they have crafted a “bracketed text” that delineates the areas of agreement and disagreement regarding the prospective trade obligations of the FTAA. This very preliminary draft needs to be supplemented by agreement on rules and procedures to guide the crucial market access negotiations, which will develop the timetable for eliminating barriers to hemispheric trade as well as limited exceptions, if any, to the free trade regime. The market access talks are not scheduled to begin until 15 May 2002.

## FTAA Scope and Coverage

FTAs come in all shapes and sizes. The NAFTA is one of the most comprehensive in terms of coverage of trade and investment in goods and services and disciplines on domestic policies that can distort trade and investment flows. Other FTAs are less ambitious. Some simply remove tariffs on merchandise trade (often with some sectoral exceptions such as agriculture). To be consistent with WTO obligations, however, FTAs and customs unions must cover “substantially all” trade in goods (GATT Article XXIV) and “substantial sectoral coverage” of services (GATS Article V).

Free trade pacts differ from the multilateral accords that have been negotiated in the GATT and the WTO in one important respect: the ultimate goal of an FTA is to eliminate “substantially all” border measures, while GATT/WTO talks pursue reforms in incremental steps.<sup>1</sup> In principle, the task of FTA negotiators should be straightforward: agree to zero trade barriers and negotiate how to get from here to there. In practice, however, negotiators face a more complicated challenge. First, they need to resolve how to deal with behind-the-border measures that may restrict trade flows, such as subsidies, health and safety standards, or “buy national” procurement regulations. This is a common problem for all trade negotiations, since these measures can provide a second tier of protection that can undercut the liberalization of border barriers to trade.

Second, they need to manage the inevitable demands from some domestic groups to exempt special programs or practices from the free trade obligations. As a practical matter, trade negotiators spend much of their time crafting rules that provide explicit exceptions (for sectors or products) or afford long transition periods before trade reforms need to be implemented, or that substantially dilute the impact of trade reforms (for example, by setting high regional content requirements to be eligible for FTA preferences).

In that regard, it is important to recognize that signing a trade pact is not the same as achieving free trade. Some trade reforms are likely to be

---

1. To be sure, the comparison of the two types of accords is more complex and over time both should tend to converge toward the common goal of global free trade (see Bergsten 1996).

implemented as soon as the pact comes into force; others will be phased in. The NAFTA, for example, provided five to 10 years for removal of most barriers, and 15 years (until January 2009) for liberalization of the most sensitive agricultural barriers to US-Mexico trade. However, because Western Hemisphere countries continue to liberalize barriers to trade pursuant to their regional trade pacts, the task of removing the remaining trade barriers may not be as onerous as it once seemed, and the potential transition period to free trade for most countries may well be much shorter than the maximum 10 to 15 years applied to some products in the NAFTA.

Moreover, once governments set a target for policy reforms, business usually accelerates the process by revising trade and investment strategies in anticipation of the prospective new regime. Such a phenomenon occurred in Europe with the announcement of the internal market reforms under the 1992 "single market" initiative, during the Canada-US FTA talks, and during the NAFTA negotiations, when investors flooded into Mexico long before the agreement was signed. In short, setting a target completion date can be a powerful signal to investors that in turn accelerates the pace of integration.

That brings us to the negotiating mandate for the Free Trade Area of the Americas. The San José Declaration, agreed by trade ministers in March 1998, set out a comprehensive agenda for an FTAA. The coverage of the prospective accord encompasses all the main areas of the NAFTA (even though the NAFTA itself is not referenced), as well as such nontraditional areas as investment and competition policy. The leaders seemed to agree that the negotiations should follow in many respects the NAFTA model but result in a new, improved, and distinct hemispheric accord.

The prospective FTAA covers a broader range of trade issues than those dealt with in the Punta del Este Declaration that launched the Uruguay Round of multilateral trade negotiations. Indeed, the FTAA countries seek to establish a WTO-plus accord that expands rights and obligations beyond those already undertaken in the multilateral trading system. Interestingly, the United States, which objected to a comprehensive agenda for a new round of multilateral trade negotiations during the WTO ministerial in Seattle in December 1999 (see Schott 2000), had accepted an even broader task in the hemispheric talks more than a year earlier. Yet the end point of free trade in the FTAA is clearly more ambitious than the WTO talks, which accommodate incomplete and incremental reforms and thus provide more flexibility to manage politically sensitive sectors. The Bush administration needs to remedy this inconsistency in US policy.

The FTAA negotiations cover three broad topics: market access reforms (including liberalization of trade barriers and removal of discrimination against foreign suppliers in the application of domestic regulations); rules covering trade and investment in goods and services sectors; and trade facilitation measures. All of these issues will be considered as a package or

single undertaking like the Uruguay Round agreements. In principle, countries will accept common obligations but negotiate different implementation schedules.

The negotiations have been organized in nine groups:

- market access issues for goods (excluding agriculture);
- agriculture;
- services;
- intellectual property rights;
- subsidies, antidumping, and countervailing duties;
- government procurement;
- investment;
- competition policy; and
- dispute settlement.

In addition, three advisory committees were created to deal with (1) problems related to the participation of small economies, (2) inputs from representatives of civil society, and (3) Internet use and obstacles to electronic commerce in the hemisphere.<sup>2</sup> Most recently, the Buenos Aires ministerial in April 2001 established a new technical committee on institutional issues to work on administrative issues such as the staffing and venue of a permanent FTAA secretariat.

One of the key tasks of the FTAA is to eliminate tariffs on both industrial and agricultural products. Tariff reform is not sexy, but would yield important welfare gains for most FTAA countries. Despite extensive unilateral liberalization and tariff cuts negotiated in the Uruguay Round, most developing countries in the hemisphere still apply relatively high tariffs.<sup>3</sup> For example, the average applied MFN tariffs in the Mercosur and Andean regions generally are three times higher than those in the United States (IDB 2000, table 15). In addition, as a result of the tariffication of quantitative farm trade restrictions in the Uruguay Round, high tariffs also are imposed on key agricultural products.

Removing agricultural quotas and subsidies will be more difficult. All countries protect their farmers and instances of negotiated liberalization

---

2. For more detail on the issues under discussion in the negotiating groups and the mandate of the advisory committees, see Salazar-Xirinachs and Robert (2001).

3. Applied rates tend to be much lower than the tariff levels that countries have bound in their WTO schedules. The gap between the two has provided flexibility for countries to impose WTO-legal protection for domestic industries without having to meet the criteria of the WTO safeguards provisions.

are few and far between.<sup>4</sup> The NAFTA, for example, provides free trade in agriculture between the United States and Mexico after 15 years but does not do so for Canada–US trade (where prior product sector exceptions negotiated in the Canada–US FTA remain in force). The free-rider problem poses serious obstacles to farm reforms in regional negotiations and thus effectively requires a complementary multilateral initiative to mitigate concerns both about imports from subsidized third-country suppliers and regional exports to foreign markets protected by high trade barriers. Parallel progress on global agricultural reforms thus may be necessary to promote agreement in this area in the FTAA negotiations.

A key aspect of the market access negotiations will be the development of rules of origin (i.e., the criteria for determining eligibility for FTAA preferences). The more complex and cumbersome the content/origin requirements, the more likely the policy will have a chilling effect on trade, and the harder it will be to administer—which can mean either more open or more protected markets, depending on the vigor of enforcement.

Industry or product-specific content requirements should be kept to a minimum. However, the most effective safeguard against abusive origin rules is multilateral tariff liberalization. Low MFN tariffs reduce the value of regional preferences and the need for regional origin rules that block transshipment of imported goods within the region that enter through member countries with lower tariffs. So the lower the MFN tariffs (and the greater the harmonization of tariffs between countries in the regional pact), the easier it is to deploy loose rather than tight rules of origin.

Negotiations on services should concentrate on supplementing commitments already undertaken sector by sector in the WTO (see Stephenson 2000), with particular attention to basic telecommunications and financial services. The FTAA provisions should also promote reforms that facilitate the development of regional transport and distribution service networks. Liberalization in these areas would contribute significantly to greater efficiency and productivity of producers of both goods and services in developing countries in the hemisphere.

In the intellectual property negotiating group, FTAA countries start from a base of extensive commitments already undertaken in the WTO agreement on trade-related aspects of intellectual property rights (TRIPS). From the North American perspective, the task of the FTAA negotiators is to build on the rights and obligations of the TRIPS accord to ensure that the protection of intellectual property contributes to the economic development of participating countries and to the ability of firms to continue to fund investment in new technologies. To be sure, implementing TRIPS obligations already poses a challenge for some countries and may dis-

---

4. The limited success of the Uruguay Round in agriculture was possible only when extensive cross-issue and cross-sector tradeoffs afforded negotiators political cover to chip away at entrenched farm trade barriers.

courage them from negotiating new rules in this area. As a first step, LAC countries that lack the trained personnel or the administrative and legal capacity to comply with current rules should be provided technical assistance by their North American partners and international agencies to facilitate the implementation and enforcement of current multilateral obligations and to promote their further elaboration. In addition, consideration should be given in the FTAA to providing a standstill on TRIPS disputes for countries that request such assistance.

The negotiations on government procurement do not have the luxury to build on extensive multilateral obligations. The WTO Government Procurement Agreement was one of the few accords not covered by the single undertaking in the Uruguay Round; rather it is one of two remaining plurilateral accords that apply only among its signatories (which does not include any LAC country). Government procurement remains a popular, if inefficient, tool of industrial policy. In some cases, restrictive public tenders provide political favors or mask corruption; often the procurement cost is inflated due to reduced competition among bidders. LAC countries would benefit from more transparent and competitive bidding on public contracts. At a minimum, all FTAA participants should commit to transparent procurement procedures and to applying them to a specific list of public tenders. Similarly, the United States and Canada should consider extending their existing WTO obligations in this area to other FTAA countries.

The investment negotiations are critically important to the LAC countries, which rely on inflows of FDI for the capital, technology, and management skills required to develop key sectors of their economies. FTAA investment obligations also could help those countries withstand the demands for overly rich incentives to build new production plants, which inevitably lead to a wasteful subsidies competition between states or provinces, or between national governments. Unfortunately, developing countries have not taken up this cause in international negotiations, even though it clearly is in their economic interests to do so (Moran 1998). The NAFTA investment provisions provide some useful precedents, although the investor-state dispute provisions would need to be modified. Many LAC countries already have introduced new investment regimes as part of their broader economic reforms, so “locking in” those policies through the international obligations of the FTAA should not prove too difficult.

The FTAA talks on competition policy have been proceeding under a mandate drawn almost verbatim from the WTO ministerial declaration in Singapore in December 1996. The FTAA trade ministers commissioned a study on the “interaction between trade and competition policy, including antidumping measures, in order to identify areas that may merit further consideration” (San José Declaration, Annex II, March 1998). To date FTAA discussions have focused on how national governments address anticompetitive business practices rather than the politically sensitive issue of whether antidumping actions impede competition. Unlike the

WTO talks, which have not advanced at all, FTAA countries have held at least preliminary discussions in this area. Given the complexities of the issues, not to mention jurisdictional conflicts within governments, progress here will perforce be taken in small, incremental steps.

Finally, the FTAA will need to deal with problems related to the implementation of national antidumping statutes. These negotiations undoubtedly will be contentious and have been delayed along with the market access talks until May 2002. On the one hand, there is strong opposition in the US Congress to “weakening” (i.e., limiting) the ability of US firms to use US trade laws to counter unfair foreign practices.<sup>5</sup> On the other hand, ongoing and new US cases grate Latin American countries even though US actions generally conform to WTO standards. These countries argue that antidumping actions effectively block access to the US market for key exports such as steel and agricultural products, and that FTAA objectives would be significantly diminished without antidumping reforms.

Interestingly, many Latin American countries are themselves bringing antidumping cases against US and other firms, and some of those proceedings lack the administrative and judicial checks and balances that restrain US petitioners.<sup>6</sup> By 2005, imposition of antidumping measures on Western Hemisphere trade (including against US exporters) will be widespread. Apart from procedural safeguards in this area, the FTAA negotiators should reevaluate the *de minimis* thresholds for taking actions against developing countries and provisions regarding the cumulation of imports for purposes of calculating the requisite degree of injury.

Some issues are ill-suited to trade pacts and are best left to other forums. FTAA members must retain responsibility for their own macroeconomic policies—monetary, fiscal, and exchange rate arrangements.<sup>7</sup> Similarly, most environmental issues should be negotiated outside the FTAA framework, though many could be addressed within the broader context of the integrated summit initiatives on sustainable energy use, biodiversity, and pollution prevention.

Labor issues, particularly the promotion of core labor standards, pose a more complex problem. The Santiago Summit Declaration included a section on the “Basic Rights of Workers”. The leaders recognized the importance of observing and promoting “internationally recognized core labor

---

5. See, for example, the letter to President George Bush, dated 7 May 2001, from 62 US senators, reprinted in *Inside U.S. Trade*, 11 May 2001. The senators argued that “whatever the motive . . . the United States should no longer use its trade laws as bargaining chips in trade negotiations nor agree to any provisions that weaken or undermine US trade laws.”

6. The Mexican experience illustrates problems that occur when adequate administrative and judicial systems are not in place; indeed, NAFTA dispute rulings overturned several initial Mexican decisions on procedural grounds.

7. However, summit leaders should direct their finance ministers and central bankers to cooperate more closely on supervision of financial markets and financial services firms. Such efforts could help forestall national financial problems from becoming regional crises.

standards” but did not mandate negotiations on labor issues in the FTAA.<sup>8</sup> Instead, the summit leaders committed to efforts to “secure the observance and promotion of worker rights, *as defined by appropriate international conventions*” [emphasis added] (Santiago Summit Declaration).

However, a few LAC countries have accepted obligations regarding core labor standards in side agreements to bilateral and regional trade agreements, or to qualify for trade benefits under the US generalized system of preferences. For example, labor provisions are covered in side pacts to the NAFTA (1993), the Canada–Chile FTA (1997), and the Canada–Costa Rica FTA (2001).

FTAA negotiators will need to find a middle ground between including a labor chapter in the FTAA like that in the US–Jordan FTA, which reportedly is unacceptable to LAC countries, and not linking trade and labor issues in the FTAA at all, which could greatly complicate US participation. As a practical matter, these issues probably have to be discussed if US trade officials are to come to the negotiating table with new trade promotion (formerly “fast track”) authority.

The compromise could draw on precedents from labor side accords that Canada has negotiated with Mexico, Chile, and Costa Rica. The obligations should ensure that national laws and regulations are transparent and faithfully implemented and enforced and that violations are redressed expeditiously. None of the Canadian pacts allow trade sanctions to be imposed as enforcement measures, but in some cases monetary fines can be assessed when there is a persistent pattern of abuse. Too often, however, enforcement problems result less from a lack of will than from inadequate resources to monitor compliance with national labor laws. An FTAA solution should thus provide “carrots” in the form of training and other assistance to promote compliance as well as “sticks” to penalize violations of national labor laws.

## The FTAA and Economic Development

What was remarkable about the Miami Summit commitments was that the developing countries in the hemisphere were in the forefront pressing for trade reforms despite the daunting prospect of open competition with the advanced industrial economies of North America. In the mercantilist calculus of trade negotiations they stand to lose the most because they maintain much higher trade barriers than the United States and Canada—but, of course, they would also gain the most in terms of increased economic welfare from eliminating those restrictions.

---

8. Like the WTO Singapore ministerial declaration in December 1996, the Santiago Declaration took note of ongoing WTO-ILO collaboration, which is limited because the ILO, unlike other international organizations, does not have observer status in the WTO.

Overall, an FTAA bargain will likely entail substantial new liberalization by Latin American and Caribbean countries in return for guarantees of continued access to the US market and the removal over time of a few notable US barriers in textiles and agriculture (as in NAFTA). In GATT-speak, the balance of concessions seems to strongly favor the industrial north. US negotiators are right to argue that it would be a good deal for the United States. The prospective FTAA will require fewer changes in current US trade barriers, laws, and regulations than those of the LAC countries.

Why would the LAC countries agree to such asymmetric liberalization? The short answer is that the FTAA would also be a good deal for them as a complement to and integral component of their overall economic development strategy. It is worth underscoring why the FTAA is important for developing countries in the LAC region.

First, the FTAA would help promote economic growth by spurring competition in domestic markets, dampening inflation, and promoting investment from both domestic and foreign sources. In addition, reforms required to implement FTAA obligations would promote transparency of public policies and contribute to efforts to combat corruption. In conjunction with broad domestic economic reforms, the FTAA would promote increased trade and investment by eliminating trade barriers, standardizing customs and other national trade practices, and creating a framework for managing trade relations among the partner countries. Much of the benefit will derive from the removal of restrictions to economic activity within each country, but countries also will gain from being able to trade and invest across a broad regional market. In so doing firms will be able to lower their costs and increase productivity through economies of scale in production and intra-industry specialization.

To be sure, industrial restructuring also adds to adjustment pressures within each economy, and is likely to incite new protectionist demands. To maintain political support for the FTAA reforms, countries will thus also need to pursue domestic programs that help affected workers retrain and companies retool for the new opportunities expanding markets create.

Second, the FTAA would provide an "insurance policy" against new protectionism at home and abroad. By establishing international obligations that effectively lock in domestic reforms, the FTAA would substantially raise the cost of policy reversals. It would thus help governments withstand the protectionist demands of their domestic lobbies and ensure that access to the markets in partner countries remains open.<sup>9</sup> Participation in the FTAA would also reinforce national economic reforms, making these countries more attractive to foreign investors. To be sure, the FTAA would not be the most important factor in attracting investment; investors

---

9. Mexico's response to the peso crisis and its ability to pursue an export-led growth recovery strategy illustrate the salutary effect of such "insurance."

will still look first and foremost at macroeconomic conditions in setting their investment priorities.

Third, the FTAA—in conjunction with ongoing subregional integration pacts and domestic regulatory reforms—would make regional infrastructure projects more viable and thus strengthen economic linkages between partner countries. Indeed, since the Miami Summit, the physical integration of the Latin American economies has been accelerated by constructing natural gas pipelines, interconnecting power grids, and expanding road and rail networks.

Fourth, the FTAA would strengthen each country's interest in the economic health and political stability of the other members. This is important because problems in one country often spill over to neighbors and trading partners. For example, the existence of NAFTA contributed to US leadership in crafting the peso rescue package in early 1995. Similarly, maintaining the integrity of Mercosur prompted leaders of Argentina, Brazil, and Uruguay to take decisive action in opposition to the attempted coup in Paraguay in 1996.

At the same time, signing a trade pact is not a magic potion that automatically creates economic prosperity. Two important points bear mention.

First, an FTAA, like all trade pacts, would create opportunities; it would not guarantee sales. To promote sustained growth and take full advantage of those opportunities, macroeconomic policy must be prudent. That is why this study places so much emphasis on readiness indicators.

Second, the FTAA is unlikely to immunize industries against antidumping actions. Like most free trade pacts, it is likely to defer to the multilateral rules in this area (and WTO rules allow trade officials great discretion in applying national laws). But there are two notable exceptions among Western Hemisphere trade pacts. The 1997 Canada–Chile FTA basically prohibits antidumping actions on products once bilateral tariffs have been eliminated.<sup>10</sup> In contrast, the NAFTA provides a less far-reaching special review procedure for final antidumping decisions, which essentially substitutes for, and expedites, judicial review of administrative actions. However, this kind of approach requires a harmonization of antidumping laws, regulations, and administrative procedures that would be difficult to achieve in other regions, much less in the hemisphere-wide talks.

## Regional Interests in the FTAA

The trade profiles of Western Hemisphere countries differ markedly from one side of the equator to the other. The total trade of countries in the

---

10. Similar exemptions from antidumping actions apply in the Australia–New Zealand Closer Economic Relations Trade Agreement and among the member states of the European Union.

**Table 3.1 Latin America and the Caribbean: Trade shares, 1999**  
(percent)

	Exports and imports from the European Union	Exports and imports from the United States	Intraregional trade as percent of total trade
Andean Community	16.6	42.6	10.2
Caribbean	14.8	31.2	7.4
Central America	11.3	49.1	16.0 <sup>a</sup>
Chile	23.4	20.5	15.5 <sup>b</sup>
Mercosur	27.3	20.1	19.8
Mexico	6.9	81.1	83.0 <sup>c</sup>

Mercosur = Southern Cone Common Market.

- a. Excludes Panama.
- b. Trade with Mercosur partners.
- c. Trade with NAFTA partners.

Source: IMF, *Direction of Trade Statistics Yearbook*, 2000.

northern half of the hemisphere is heavily dependent on the US market. The Caribbean Basin countries—the majority of FTAA participating countries—conduct between one-third and one-half of their trade with the United States, while the US market accounts for more than 80 percent of Mexican trade.

By contrast, the Mercosur countries and Chile have more diverse and global trading interests. Their main trading partner is the European Union; the US market accounts for only about 20 percent of their total trade. Intraregional trade throughout Latin America and the Caribbean is small (less than 20 percent of total trade), though significantly higher than a decade ago (table 3.1 and IDB 2000, table 1).

To some extent these differences in trade patterns are reflected in the priority countries place on the FTAA negotiations. For many of the 34 participating countries, the FTAA is the main trade event. For others, a new WTO round and other bilateral and regional trade initiatives merit equal or greater attention. However, all 34 countries (including the United States and Canada) share a need to improve their global competitiveness that can be advanced through a combination of domestic reforms, regional integration pacts, an FTAA, and new multilateral liberalization in the WTO. The following sections summarize key interests of the United States, the Mercosur countries, and the small economies of Central America and the Caribbean in successful conclusion of FTAA negotiations.

## US Interests in the FTAA

When US–Mexico free trade talks were first broached in 1990, few realized how closely integrated the two economies already were, or how

closely US interests coincided with the promotion of economic growth and political stability in the region. To a somewhat lesser extent, the same situation holds today with respect to US interests in Latin America and the Caribbean. The United States has an important stake in the economic health and political reform of its southern neighbors; the FTAA can make an important contribution to a more prosperous and democratic hemisphere.

The United States has two overarching goals in pursuing an FTAA: (1) free trade in the Americas is an integral component of a global US trade strategy designed to reduce barriers to trade and investment and thereby increase US trade, production, and the productivity and income of US workers, and (2) the FTAA is the linchpin of the broad array of summit initiatives that seek to promote closer cooperation in the hemisphere on pressing economic, social, and political problems.<sup>11</sup>

The trade objective is straightforward. Breaking down Latin American trade barriers will yield important new opportunities for US firms to export and invest. It will also avert discrimination against US-based producers as a result of free trade pacts that those countries have or may sign with each other and with the European Union.<sup>12</sup> US firms and US workers both benefit, because exporting firms generally pay higher wages and offer steadier employment than firms that do not export (Richardson and Rindal 1996). The same applies to US firms that invest abroad, because they also are significant exporters. Moreover, the FTAA would help level the playing field for US-based exporters by reducing discrimination that results from other FTAs in the region to which the United States is not a party. In some cases, such pacts have forced US firms to source their exports from their foreign instead of domestic production plants, to the detriment of US workers.

US trade and investment linkages with LAC countries are strong and increasing steadily. The LAC region already is an important export market for US companies, and has become increasingly attractive as economic reforms implemented over the past decade have taken root. The LAC region, including Mexico, now accounts for about 22 percent of total US merchandise exports (table 3.2) and 17 percent of US imports (table 3.3). US exports to the region have almost tripled from \$63 billion in 1991 to \$171 billion in 2000 and have grown twice as fast as US exports to the rest of the world.<sup>13</sup>

---

11. This section draws on Schott and Hufbauer (1999) and Hufbauer, Schott, and Kotschwar (1999).

12. For an analysis of European free trade initiatives in the Americas, see Schott and Oegg (2001).

13. US–Mexico trade accounts for more than half of those totals, even though Mexico produces only about a quarter of LAC regional output. Even excluding Mexico, US exports to the LAC region still grew substantially faster (almost 40 percent) than shipments to other countries.

**Table 3.2 US merchandise exports (billions of US dollars)**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Argentina	2.0	3.2	3.8	4.5	4.2	4.5	5.8	5.9	4.9	4.7
Brazil	6.1	5.8	6.1	8.1	11.4	12.7	15.9	15.1	13.2	15.4
Chile	1.8	2.5	2.6	2.8	3.6	4.1	4.4	4.0	3.1	3.5
Mexico	33.3	40.6	41.6	50.8	46.3	56.8	71.4	78.8	86.9	111.7
LAC region (including Mexico)	63.4	75.8	78.4	92.5	96.3	109.4	134.4	142.2	142.1	171.0
Total US exports	421.7	448.2	465.1	512.6	584.7	625.1	689.2	682.1	695.8	782.4
<b>Latin America/total US exports (percent)</b>	<b>15.0</b>	<b>16.9</b>	<b>16.9</b>	<b>18.0</b>	<b>16.5</b>	<b>17.5</b>	<b>19.5</b>	<b>20.8</b>	<b>20.4</b>	<b>21.9</b>

LAC = Latin America and the Caribbean.

Source: US Department of Commerce, *Commerce News*, <http://www.doc.gov>.

**Table 3.3 US merchandise imports (billions of US dollars)**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Argentina	1.3	1.3	1.2	1.7	1.8	2.3	2.2	2.2	2.6	3.1
Brazil	6.7	7.6	7.5	8.7	8.8	8.8	9.6	10.1	11.3	13.9
Chile	1.3	1.4	1.5	1.8	1.9	2.3	2.3	2.5	3.0	3.2
Mexico	31.1	35.5	39.9	49.5	61.7	74.3	85.9	94.6	109.7	135.9
LAC region (including Mexico)	62.5	68.7	74.4	88.0	104.6	123.8	139.6	144.9	168.2	209.2
Total US imports	488.4	532.7	580.7	663.3	743.4	791.4	870.7	911.9	1,024.6	1,216.4
<b>Latin America/total US imports (percent)</b>	<b>12.8</b>	<b>12.9</b>	<b>12.8</b>	<b>13.3</b>	<b>14.1</b>	<b>15.6</b>	<b>16.0</b>	<b>15.9</b>	<b>16.4</b>	<b>17.2</b>

LAC = Latin America and the Caribbean.

Source: US Department of Commerce, *Commerce News*, <http://www.doc.gov>.

Similarly, US imports from the LAC region, including Mexico, more than tripled, reaching \$209 billion in 2000. They grew 40 percent faster than imports from the rest of the world. However, when Mexico is excluded, the import growth rates were identical. Sales to the US market represent about two-thirds of all merchandise exports by the LAC countries.

US investors also have a significant interest in the Latin American economies. During the 1990s, US FDI in the region tripled, to a cumulative \$223 billion in 1999 (on a historical cost basis), representing 13 percent of all US FDI.<sup>14</sup> Excluding FDI in offshore financial centers, almost 60 percent of US investments in the LAC region were in Brazil (\$35 billion) and Mexico (\$34.3 billion).

To be sure, US trade and investment ties to the LAC region seem more modest if one excludes Mexico, where the NAFTA is already in effect. However, the potential trade expansion from a free trade pact with growing markets in Latin America, if comparable to the growth achieved under NAFTA, would be significant. Using a gravity model developed by Jeffrey Frankel (1997), Schott and Hufbauer (1999) estimated the potential increase in US–Brazil trade if Brazil received the same trade treatment as Mexico in the US market (adjusting for differences between Mexico and Brazil in size, geography, and per capita income). In other words, if Mexico were transplanted to Brazil but remained a NAFTA member, how much trade would it conduct with the United States? Updating the analysis with data for 2000, US–Brazil trade would be about \$86 billion, almost three times greater than the actual volume in 2000 of \$29 billion. To achieve these gains, however, most US and Brazilian trade barriers would have to be covered by the free trade pact.

Second, the United States benefits when its neighbors prosper and democratic processes deepen. The FTAA would help strengthen the economic foundation on which LAC countries have built their democratic societies. Furthermore, the prospect of improved trade relations can act as a magnet for attracting support in the LAC countries for other important US political and foreign policy goals, including cooperation on drug interdiction, improving environmental and labor conditions, supporting educational reforms, and reinforcing democracy. Thus, an FTAA could have important spillover effects on overall US relations with the region. This point is well illustrated by the 2000 Mexican presidential election, which demonstrated the salutary effect of economic integration on political reform.

## **Mercosur and the FTAA**

Like the United States, the Mercosur countries—especially Brazil—have a strong and growing interest in trade with other countries in the hemi-

---

14. However, the total figure overstates the US stake in the real economy of Latin America, since 46 percent of these investments were placed in offshore financial centers (US Department of Commerce, Bureau of Economic Analysis, <http://www.bea.doc.gov>).

sphere. They share with their North American partners, too, the broad objective of contributing to more prosperous and democratic societies in Latin America and the Caribbean through the successful conclusion of a FTAA.

Although the Mercosur countries speak with one voice in the FTAA negotiations, in reality positions and priorities differ significantly among the four members. In part this reflects differences in the importance and composition of international trade in each economy. Brazil and Argentina remain relatively closed economies; their ratio of trade (exports and imports) to GDP in 1999 averaged only about 15 percent. However, both rely heavily on inflows of FDI to help finance the development of key sectors, such as energy, telecommunications, and banking. Over the past few years, FDI inflows nearly equaled their current account deficits (IDB-INTAL 2000). In contrast, Paraguay and Uruguay depend on trade (largely with their Mercosur partners) for about 30 percent of GDP and receive much less investment from outside the region.

Like other LAC countries, the Mercosur partners need to consolidate the gains from their regional integration arrangements if they are to take advantage of the new trade opportunities that can be created by an FTAA. Because opening their markets has been an important component of their development strategies, they cannot afford to postpone progress in hemispheric talks while their economies restructure. Rather, they need to increase competition in the Mercosur marketplace; reciprocal free trade pacts with their principal trading partners will support that goal and should be a key part of their development strategy.

In the aggregate, the Mercosur countries have important trading interests around the globe. The European Union, the leading trading partner, accounted for about 27 percent of total Mercosur trade in 1999. However, about half of the Mercosur trade is conducted with partners in the Western Hemisphere (including intraregional trade that accounts for about 20 percent of the total). Asia, primarily Japan, accounts for about 10 percent (IDB 2000, table 7).

In terms of its trading interests in the FTAA, Brazil gives priority to trade in manufactures while Argentina seeks reform of agricultural trade barriers and subsidies. On agricultural issues, the Mercosur and the United States share common interests in most areas (including cutting back export subsidies), but have longstanding disputes over US restrictions on sugar and citrus products. The latter problem is less critical than in the past, however, due to extensive investments by Brazilian firms in US production but remains a source of friction in US-Brazil trade relations.

Trade in manufactures offers the broadest scope for growth, in part due to restrictions that continue to inhibit shipments between North and South America. About 60 percent of Brazilian exports to the United States are manufactures. Brazil's ambassador to the United States, Rubens Barbosa, argued in 2000 that his country's weak export performance in the

US market resulted from discriminatory treatment due to NAFTA, self-inflicted wounds (i.e., the “Brazil cost”), competition from other countries, and US import restrictions (Barbosa 2000). For Brazil, the FTAA offers the prospect of breaking down US trade barriers, including high US tariffs on textiles and clothing, and eliminating the discrimination that Brazilian exporters currently face in the US market due to NAFTA and Caribbean Basin Initiative (CBI) preferences. Obviously, Brazilian exporters would benefit significantly from the potential growth in bilateral trade cited above, but only if restrictions *at home and abroad* are lifted.<sup>15</sup>

Perhaps the most intractable problem facing Mercosur’s negotiators in the FTAA is the incidence of US antidumping actions against its exports. The Mercosur countries are not opposed to antidumping laws; indeed, they use them with increasing frequency. But they are concerned that, in some cases (primarily in the steel trade), antidumping measures have become permanent restrictions that often are exempt from the liberalization commitments undertaken in the WTO and potentially in the FTAA. Indeed, US reluctance to discuss antidumping reforms in the FTAA has contributed—in the words of Brazil’s Foreign Minister Celso Lafer—to “the perception [in Brazil] that much is expected from our side but little is offered in exchange” (Lafer 2001).

Finally, like the United States, Brazil and its partners “share a desire and commitment to see this entire region prosper in economic terms and consolidate its democratic institutions” (Barbosa 2001, 156). Brazil borders all but two of the countries of South America and has an interest in mitigating problems abroad before they create problems at home. The current turmoil in the Andean region is a case in point; it was a central concern of the Brasilia Summit of South American leaders organized by President Fernando Henrique Cardoso in August 2000. To the extent that free trade in the Americas helps those countries recover from their economic malaise and reinforces democratic governance, it will strongly serve Brazilian and Mercosur interests.

## Small Economies and the FTAA

The small economies of the Caribbean Basin represent almost two-thirds of the countries negotiating the FTAA.<sup>16</sup> They all depend to a large extent on foreign trade and investment—with trade-to-GDP ratios of 40 percent or more for the Caribbean nations—but many of these countries are wary

---

15. In particular, Brazilian domestic policies need to remedy the “Brazil cost” problems such as the high cost of credit, regulatory bottlenecks, and uneven tax burdens.

16. “Small” is a relative term used to classify countries by level of output, land mass, and population. For a useful examination of these issues and of the impact of trade liberalization on small economies, see Michaely and Papageorgiou (1995).

of entering into a reciprocal free trade pact with their industrial neighbors in North America. Given their size, heavy reliance on the production and trade of a single commodity or service, underdeveloped physical infrastructure, and limited human and technological resources, they are increasingly vulnerable to changes in foreign demand and supply and the gyrations of foreign capital and exchange rate markets. On the other hand, because of their size, they cannot afford to isolate themselves from their major markets, because they are unlikely on their own to reap sufficient economies of scale and scope to compete effectively in global markets. For small economies, the issue is not whether to integrate with their hemispheric trading partners, but how.

For small economies, the attraction of the FTAA is also the main challenge. The trade pact provides an opportunity to reinforce domestic reforms and to create growth opportunities in both traditional and new sectors. During its negotiation and phased implementation, these countries need to diversify production, increase efficiency in traditional export sectors (i.e., looking downstream in traditional commodity production), and develop new services exports.<sup>17</sup> Trade reforms should be part of a broader “global repositioning strategy” that encourages new investment and allows each country to respond more effectively to changing conditions in global markets (Bernal 2000).

The challenge for these countries is twofold: encourage growth in trade and inward investment from their FTAA partners, and restructure their economies to diversify production and expand employment opportunities (to address their high unemployment problem discussed in chapter two). That is why these countries placed such high priority on attaining “NAFTA-parity” through an enhancement of the preferences under the CBI. Note, however, that the CBI legislation enacted in May 2000 was designed to be a temporary way station on the road to the reciprocal free trade obligations of the FTAA.

To achieve these goals, smaller countries will need to accelerate the pace of their domestic reform. As a practical matter, such policies are necessary with or without an FTAA. However, the FTAA could be crafted to help manage the adjustment of small economies to more open competition. In particular, smaller partners should be given more time, if they need it, to implement liberalization commitments and new trading rules for certain products or sectors and on a country-by-country and case-by-case basis. However, there should be a fixed end date for full implementation of the agreement that is not too short as to be impractical but not too long that it provides little incentive for change.

---

17. This argument is a central point in the 1997 report of the Independent Group of Experts on Smaller Economies and Western Hemispheric Integration, of which I was a member (IGE 1997, 15).

Depending on the content of the FTAA, these countries also may need to upgrade their administrative capabilities or create regional institutions to complement or supplement them. Some small economies will require technical and financial assistance to improve their ability to administer the policies required by new trade obligations and to support new infrastructure projects. Such assistance will be particularly valuable in helping these countries deal with complex regulatory issues such as competition policy, the protection of intellectual property rights, and the supervision of financial service industries. Most important, these countries will need to overhaul their tax regimes so that they are less dependent on revenue from trade taxes. As an interim step, they should phase in a uniform tariff that then can slowly be phased out and replaced by a value-added tax.

To support these objectives, small economies should seek both technical and financial assistance from multilateral development banks (MDBs) and national development cooperation agencies in planning local and regional infrastructure projects. The International Monetary Fund and central banks also could provide expertise on tax reform as well as training of bank supervisors and other regulatory officials to support financial sector reforms. The Quebec Summit leaders recognized these needs and “the essential role of the MDBs and funding agencies in mobilizing expertise and resources.” In addition, they instructed finance ministers to consider “the establishment of financial mechanisms to support the Summit initiatives” (Quebec Summit, Plan of Action, see chapter 1, footnote 16). Making good on these commitments will support economic development in the Caribbean Basin and facilitate the participation of these small countries in the FTAA.