

# CRS Report for Congress

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

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 completing a Free Trade Area of the Americas (FTAA) by January 1, 2005. Nine years later, the third draft text of the agreement was presented at the November 2003 Miami trade ministerial. The Ministerial Declaration, negotiated largely by the two co-chairs, Brazil and the United States, took the FTAA in a new direction, away from the comprehensive, single undertaking principle, toward 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 early 2004 in Puebla, Mexico was unable to clarify this concept, highlighting the deep differences that remained between the United States and Brazil. FTAA talks subsequently stalled and the original January 1, 2005 deadline was missed. In the meantime, both Brazil and the United States are pursuing subregional trade pacts that may further complicate the negotiation process. Talks between Brazil and the United States may resume in early 2005, but it is still unclear if significant progress can be made on the FTAA this year. This report will be updated.

### **Background and Negotiation Process**

In the aftermath of the 1980s debt crisis, much of Latin America embraced broad economic policy reform that included major strides toward trade liberalization. This trend 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. Examples include the North American Free Trade Agreement (NAFTA), the Southern Common Market (Mercosur), the Andean Community, the revitalized Central American Common Market (CACM), and most recently, the South American Community of Nations, established in December 2004. Combined with unilateral, bilateral, and multilateral efforts, these subregional agreements

have fostered trade opening, with average tariff rates in Latin America falling from 40% in the mid-1980s to under 12% by 2000.<sup>1</sup>

Despite the noted progress in Latin America's trade liberalization, the multiple free trade agreements (FTAs) that the "New Regionalism" cultivated also created inefficient and discriminatory trading patterns. The impetus to simplify this situation, combined with the conviction that trade liberalization is a cornerstone for reform and development, has generated widespread support for an FTAA. The United States has led the FTAA effort in expectation that it not only would open markets for U.S. goods and services, but would provide benefits to the entire region by: 1) increasing Latin American trade with the large U.S. market; 2) fostering reciprocal trade among Latin American countries; and 3) encouraging more foreign direct investment in Latin America.<sup>2</sup>

After ten years, the negotiations stalled in 2004, missing the January 1, 2005 completion deadline and exposing, more clearly, the challenges to the negotiation process. First, there are fundamental differences in the needs of developed and developing countries that have proven difficult to reconcile. Second, import competing industries have raised concerns in all countries, that together, have slowed progress. Third, social issues, such as labor and environmental provisions, have yet to be tackled in detail. Fourth, helping all countries, big and small, take advantage of an FTAA has raised awareness that a comprehensive trade-related capacity building system will be needed.

The negotiation process is organized into nine working groups responsible for: market access; agriculture; investment; services; government procurement; intellectual property rights; subsidies, antidumping, and countervailing duties; competition policy; and dispute settlement. The groups are directed by the Trade Negotiations Committee (TNC) and each is chaired by a different country on a rotating basis. There is also a consultative group on smaller economies, a committee on civil society to provide input from non-government parties (e.g. labor, academia, and environmental groups), a technical committee on institutional issues, and a joint government-private sector committee of experts on electronic commerce. Draft FTAA texts are released in all four official languages, with "bracketed text" reflecting areas of disagreement.<sup>3</sup>

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 negotiating process to its completion. The third draft text was completed for the November 20-21, 2003 FTAA ministerial in Miami.<sup>4</sup>

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<sup>1</sup> 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.

<sup>2</sup> Ibid., pp. 24-29.

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

<sup>4</sup> 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 José (1998), Toronto (1999), Buenos Aires (2001), Quito (2002), and Miami (2003). Brazil will host the next, still unscheduled, trade ministerial.

## Major Negotiation Issues

The FTAA began as a commitment by 34 countries to consider a comprehensive trade agreement to be accepted as a single undertaking — all parties would have to agree to it as a whole. This has proved to be a challenging task given that 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 because the two largest regional economies, Brazil and the United States, have different priorities. The United States, although having the lowest average tariff rate in the Western Hemisphere of less than 4%, maintains high peak tariffs, uses tariff rate quotas (TRQs), and heavily subsidizes many agricultural products. A concentrated group of industrial products are subject to antidumping duties that affect Latin American countries. By contrast, Brazil has much lower peak tariff rates, but the second highest average regional tariff rate of 15% and relies on other trade barriers, as well.<sup>5</sup> The United States, therefore, has focused its attention on eliminating tariffs broadly, whereas Brazil and other countries want to address peak tariffs and TRQs.

Latin American efforts to address U.S. trade remedy laws and domestic support programs have focused specifically on opening the U.S. market further to its agricultural, steel, and textile exports. Agriculture is the most protected sector in most economies and for most Latin American countries, contributes significantly to economic output, employment, income, and exports. Historically, it has proven to be the most difficult area 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 hurt U.S. exporters in the Latin American market relative to other agricultural exporting countries that subsidize, and diminish the U.S. multilateral bargaining position on subsidies in the broader World Trade Organization (WTO) talks.<sup>6</sup> Therefore, progress in the Doha Round on agriculture issues could present an opportunity to accommodate a major sticking point in FTAA talks.

**Other Trade Barrier Issues.** The United States is also interested in non-goods trade, areas in which it has a comparative 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 U.S. issues. Intellectual property rights violations have hurt U.S. producers throughout much of Latin America and no country has laws equal to the United States in protecting intellectual property. IPR rules, however, have been criticized for increasing the financial burden on developing countries and there are competing views as to whether greater IPR protection will increase or diminish levels of technology transfer and foreign direct investment. Competition policy is another difficult area because of the need to change regulatory regimes covering

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

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

domestic economic activity. In government procurement, many Latin American countries, including Brazil, are reluctant to open up their systems, preferring instead to support, if not protect, domestic industry participation.

**Labor and Environment Provisions.** The labor and environment issues are critical for U.S. passage, but resisted by developing countries, who argue 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. Advocates for including these issues see lower standards as a way to provide an exploitive and unfair competitive advantage (lower costs), which should not be a basis for exporting nor for attracting foreign investment, and that higher U.S. standards should 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. In response to labor and environment advocacy groups, the United States set the precedent of including relevant provisions in all its FTAs, but there is still considerable disagreement over how strong the language should be, particularly in enforcing International Labor Organization (ILO) basic principles, and in defining the dispute settlement mechanism.<sup>7</sup> The FTAA debate has yet to focus on this concern in detail, but when market access issues are concluded, it will eventually become a core issue.

## **Status of Negotiations: A Two-Tier FTAA?**

Over the past year, formal FTAA negotiations stalled. As the FTAA co-chairs, Brazil and the United States continued to meet bilaterally to work on a framework for moving ahead. Negotiators have faced a huge challenge in trying to meet the divergent interests of 34 countries that vary in size, economic capability, and political interest. When the FTAA negotiations began, they were predicated on the assumption that all countries could gain from a comprehensive and inclusive agreement, one that addresses everything from market access to trade remedies and rules-based issues. It now appears that few countries may be ready to accept such deep obligations. The issues are 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.

Tension between the United States and Brazil heightened in May 2003 when Brazil challenged three U.S. policy initiatives. First was U.S. pursuit of subregional trade arrangements (NAFTA, the Andean Trade Preference Act (ATPA), the Caribbean Basin Initiative (CBI), and bilateral deals), which Brazil suggested isolates Mercosur in the context of the FTAA negotiations. Second, Brazil argued that U.S. refusal to address agricultural subsidies and antidumping disciplines in the FTAA affected its key export sectors. Third, the U.S. offer of “differentiated” market access gave Brazil 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

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<sup>7</sup> 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>].

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 more comprehensive agreement.

Brazil’s strategy rests on two negotiating pillars. Offensively, to support its growing agricultural export sector, it wants to change agriculture market access rules and has refused to consider many U.S. issues unless domestic subsidies are included in the talks.<sup>8</sup> 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 Mercosur trade and domestic market development. Brazil is also the least dependent of all the Latin American countries on the U.S. market and has no regional U.S. preferential arrangement at stake to protect (e.g. CBI), so it has resisted pressure to accept a deeper FTAA or to diminish its expectations for greater U.S. agricultural market access.<sup>9</sup>

The U.S.-Brazil differences were the major factor that determined the outcome of the 2003 jointly-authored *Ministerial Declaration*, which defined how the negotiations would proceed. Although the ministerial declaration reaffirms the commitment to complete a “comprehensive and balanced” agreement, 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 trade negotiating committee (TNC) was instructed to clarify the differences.

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 action on 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.

## Outlook

Latin America’s New Regionalism is thriving, although it is not clear that this will lead to an FTAA. Both Brazil and the United States are courting other countries for their

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<sup>8</sup> This despite evidence that ending agricultural subsidies would increase FTAA agricultural trade very little compared to a far bigger gain that would come from eliminating tariffs, particularly for Brazil. Salazar-Xirinachs, José M. Development Issues Posed by the FTAA. In Weintraub, Sidney, Alan M. Rugman, and Gavin Boyd, eds. *Free Trade in the Americas: Economic and Political Issues for Governments and Firms*. Cheltenham, Edward Elgar Publishing, Inc. 2004. p. 238.

<sup>9</sup> Lorenzo, Fernando and Rosa Osimani. *Negotiations of the Mercosur with the FTAA and the U.S.* Red de Investigaciones Económicas del Mercosur. Montevideo, Uruguay. July 2003.

support in the FTAA negotiations and as partners in bilateral or subregional agreements (the de facto default approach to a stalled FTAA). Progress on the FTAA itself, including setting a date for the next ministerial, still rests with Brazil and the United States agreeing to a detailed framework on how to proceed with the negotiations. This goal remains elusive, but meetings between their trade representatives are expected to begin anew in early 2005.

In the meantime, the United States is pursuing bilateral FTAs with Central America, the Dominican Republic, and three of the Andean countries. The USTR has formulated a framework for negotiating these FTAs that relies on identical or similar language for many of the chapters, with detailed market access and other schedules developed for each country. This allows for considerable flexibility in addressing sensitive products and disciplines within a comprehensive agreement that includes many of the critical U.S. issues such as services trade, investment, government procurement, intellectual property rights, labor, and environment concerns, but avoids any mention of domestic subsidies and antidumping. As well as this approach has worked on a bilateral basis (opinions differ on this, but FTAs are being implemented), the United States has so far not been able to replicate it at the regional level.

Nor has Brazil stood still in the regional integration game. Mercosur (led by Brazil, but which includes Argentina, Uruguay, and Paraguay) has added eight associate members and succeeded in consummating a long-awaited political and economic pact with the Andean Community in October 2004. Brazil pushed the integration effort one step further on December 9, 2004, when twelve countries agreed to form the South American Community of Nations, a goal Brazil hopes will increase South America's bargaining position in the FTAA. The South American Community is a loose agreement calling for lowering tariffs and improving political dialogue, but entails far less of a commitment than the FTAs that these countries are negotiating with the United States.

As the FTAA negotiations continue, the trade dynamics of the region are clearly changing. Since nearly all the South American countries have entered into some type of agreement with both Brazil and the United States, an interesting negotiation picture is developing, with the possibility that dual commitments could further complicate FTAA discussions. Negotiating leverage may depend on how successful these various arrangements are perceived to be, which may raise the stakes on U.S. congressional action on implementing legislation for the DR-CAFTA, Panama, and Andean agreements.

The FTAA was initially proposed to simplify trade relations with a balanced, comprehensive, single undertaking in which all countries would be treated equally. This proved to be too difficult, slowing progress and giving way to a host of subregional agreements that will likely further complicate trade and investment decisions, if not the FTAA negotiations themselves. It is not clear how much progress on agricultural issues can be made in the WTO, but it would help move the FTAA along. Other divisive issues exist that inspired a two-tier strategy. To work with this approach, Brazil and the United States will have to come up with some creative solutions if the FTAA is to be a meaningful improvement over the status quo, and also not run afoul of WTO rules on FTAs. Few see a final agreement being reached in 2005, but getting the framework settled would go a long way toward making it a real possibility sometime in the future.