STRATEGY RESEARCH PROJECT

HEMISPHERIC FREE TRADE: REALITY OR LOST OPPORTUNITY?

BY

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ABSTRACT

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With democratic reforms and the development of market economies well underway, Latin America is emerging as one of the fastest growing regions for US goods and services. The most significant outcome of the 1994 Summit of the Americas was the commitment of all freely elected leaders in the hemisphere to expand the free trade provisions outlined in the newly ratified North American Free Trade Agreement to the entire Western Hemisphere. Dubbed the Free Trade Area of the Americas, a goal was established for a negotiated agreement by 2005. President Clinton pledged full US support for this initiative. However, with the approach of the next summit in 1998, both the commitment and leadership of the United States toward expanded free trade in the hemisphere are being questioned. This paper will examine the developments affecting the realization of a hemispheric free trade area and the leadership role of the United States.

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INTRODUCTION

The transformation process toward democracy and major economic reform that began in the eighties throughout Latin America has solidified in the 1990's. All Latin American countries except Cuba have transitioned to democratic forms of government. While competition among political parties and candidates may not yet mirror US politics, political choice is expanding as these changes take root in Latin American societies.

Among the more tangible results emerging from recent changes in Latin America has been the transition to market economies. During 1997 many of the region's economies experienced their highest rate of growth in a quarter century. Despite some instability in Latin American markets resulting from the Asian financial crisis, the combined average growth rate for the region reached 5.3% as compared to 3.2% from 1991 through 1996.[1] After hyperinflation crippled many Latin American economies in the eighties, the average inflation in 1997 dropped to just over 10 percent. Additionally, trade continued to increase throughout the region and unemployment decreased slightly.[2]

The commitment to democracy and market economies throughout Latin America provides the United States with its best opportunity in recent years to pursue a common hemispheric agenda for the future. Progress in key areas such as the restructuring of economic institutions, the control of inflation, the return of growth and the strong flow of foreign capital provide the foundation for a common economic agenda for the whole hemisphere that was undreamed of even a decade ago.[3]

As is so often the case, the leadership of the United States is critical to both fostering and capitalizing on these historic opportunities. Freed of many of the security concerns that dominate US relations with other regions of the world, the United States can concentrate its energies and resources on other issues of mutual interest. At the forefront of these possibilities is increased trade and economic integration within the Western Hemisphere.

This paper will examine recent developments affecting the realization of a hemispheric free trade area and the leadership role of the United States.

ENTERPRISE FOR THE AMERICAS

In June 1990 President Bush unveiled a new effort aimed at revitalizing relations between the United States and Latin America. Known as the Enterprise for the Americas Initiative (EAI), EAI had three principal components: trade, investment and debt relief. Of these, trade had the greatest potential for transforming commercial relations between the United States and Latin America while substantially aiding the development prospects of the southern region. The ultimate goal of EAI, a Western Hemisphere Free Trade Area, offered opportunities for mutual gains by all nations.[4]

SUMMIT OF THE AMERICAS

Building on the vision of President Bush, in 1994 President Clinton invited the elected leaders of the Western Hemisphere to the Summit of the Americas held in Miami. This was the largest gathering of hemispheric leadership in history and a testimony to the ascendance of democracy and economic reform throughout the region.[5]

Although the Summit of the Americas action plan yielded four overarching goals and nearly two dozen supporting initiatives, the consensus for free trade and economic integration of the hemisphere was viewed by most as the centerpiece of summit accomplishments. President Clinton enthusiastically pledged US support for the initiative in his remarks at the conclusion of the Summit.

> This is more than words; this is a commitment to deeds. Free trade in our hemisphere has been talked about for years, but because of the process we've launched this weekend it will now become a reality. Free trade will yield dramatic benefits in terms of growth and jobs and higher incomes. It will permit us to pursue economic opportunities, and at the same time, to reaffirm our commitment to promote the rights and interests of our workers so that all our people have the chance to benefit from free trade.[6]

As noted in President Clinton remarks, free trade within the hemisphere was not a new idea. However, earlier declarations of support for the concept were not accompanied by the necessary means to facilitate accomplishment. To ensure a reasonable chance of success this time, a framework for the process was developed. Summit leaders set 2005 as the milestone for the completion of negotiations leading to the establishment of a Free Trade Areas of the Americas (FTAA).[7] Considering the enormous complexity of multilateral trade issues, this timeline was an ambitious undertaking.

The plan of action also called for trade ministers to take the initial steps necessary to achieve the FTAA, to review the progress of the working groups and make recommendations.[8] At the first of these ministerial meetings in 1995, seven working groups were established to address technical areas such as access to markets, investment, and customs procedures. In 1996 at the second ministerial meeting, four additional working groups were formed to address government procurement, intellectual property rights, services, and competition policy.[9] Most recently, a twelfth working group was designated to develop dispute resolution mechanism. Each working group has a designated country chair with the United States assigned responsibility for government procurement.[10]

SUBREGIONAL TRADING ALLIANCES

While leaders in Miami declared their commitment to hemispheric free trade in the next century, the tangible results on trade in the 1990's have come in the form of new and expanded subregional trading alliances. Over 30 free trade accords are now in effect in the hemisphere with the majority having been concluded in the 1990's.[11]

The two most important multilateral trading arrangements are the North American Free Trade Alliance (NAFTA) in North America and Mercosur in South America. Several older subregional trade groups, such as the Andean Community, the Caribbean Community, and the Central American Common Market, have all taken recent steps to liberalize their existing arrangements.[12]

Gaining the necessary bipartisan Congressional support, President Clinton successfully led the bid for passage of the North American Free Trade Alliance (NAFTA) in 1994. Joining together the United States, Canada and Mexico, this accord created the world's largest free trade area and is the most comprehensive arrangement in the hemisphere. The alliance represents over 385 million people and a combined gross domestic product of over $7 trillion dollars.[13]

NAFTA contains several key provisions that distinguish it from its counterparts in the hemisphere. The alliance provides protection for investment and intellectual property rights, applies rules to government procurement and contains a dispute settlement system. These areas are included in the FTAA working group process, reflecting the priority of these issues to the NAFTA signatories.[14]

A distinct feature of NAFTA is two side agreements on labor and the environment. Their inclusion in NAFTA aims to institutionalize improved working conditions and living standards in each country and to address and resolve environmental issues between the parties.[15] Since the United States and Canada maintain superior living and working conditions, it can be assumed that the labor provision is directed to the challenges confronted by the Mexican citizenry. This is an important distinction since the FTAA would expand trade with many Latin American countries that face labor and environmental issues at least as significant as Mexico. These issues have already led to political divisions in the US Congress that contributed to successive defeats of presidential fast track authority.

The passage of NAFTA played a key role in generating the interest and optimism for hemispheric free trade at the Summit of the Americas. However, with 2005 a long way off, countries in Latin America have likewise made major strides toward economic integration of the southern half of the continent. This region is now the world's fourth largest integrated market after NAFTA, the European Union and Japan.[16]

The most noteworthy of the southern trade alliances is Mercosur, linking Brazil, Argentina, Uruguay and Paraguay. These neighbors represent a population of 220 million and a combined gross domestic product of nearly one trillion dollars.[17] Only recently established in 1991, Mercosur has made impressive gains in a short duration when measured against every established economic indicator.[18]

Mercosur differs in approach from NAFTA in that Mercosur is a customs union with a unified trade policy. The union not only functions as a free trade area, but has also established a common external tariff for imports to its countries. In contrast, the NAFTA countries maintain their own trade policies on import tariffs. The approximately 85 percent of imports from outside Mercosur are under the common external tariff, while nearly 90 percent of all intra-Mercosur commerce is duty free. Unlike NAFTA, Mercosur does not include provisions for intellectual property rights or government procurement.[19] These differences in approach from NAFTA will likely influence both the path and process toward realization of FTAA.

Mercosur has aggressively sought new markets for its exports. When NAFTA faltered on its commitment to extend membership to Chile, Mercosur took advantage of the opportunity.[20] In 1997 both Chile and Bolivia became associate members of the alliance. Free trade negotiations with other Latin American countries are at various stages leading to speculation that Mercosur may evolve into a South American Free Trade Alliance as a counter to NAFTA.[21]

Another area of expansion coveted by Mercosur is the European Union (EU), representing a substantial number of European countries. The EU and Mercosur are actively working toward an alliance of their own in 1999.[22] Such a union would further enhance the negotiating position of Mercosur in hemispheric free trade talks.[23]

While the benefits of subregional trading alliances are many, the trend also brings inherent risks to the realization of a hemispheric trade area. These agreements may provide the building blocks on which the Free Trade Area for the Americas is ultimately built. On the other hand, firms may be so comfortable with these agreements that they balk at the risks from competition with expanded trading partners. The private sector that has benefited from expanded trade in the 1990's could evolve into a powerful anti-trade expansion lobby in the future.[24]

SUPPORT FOR DEMOCRACY

An underlying goal associated with the subregional trading alliances in South America is to strengthen the hand of democracy. While trade agreements do not typically address support for democracy, the preamble to the recent Mercosur-Chile agreement includes a statement on the importance of democratic institutions. These alliances create an incentive for countries to stick with democracy when they might be tempted to do otherwise.[25]

The recent case of Paraguay illustrates how economic integration can further the goal of stable democracies. In an attempted coup in May 1996, Paraguay's Mercosur partners actively worked alongside the United States, the Organization of the American States and others to save the democratically elected government. The threat of withdrawal of Mercosur trade benefits increased the perceived costs of the coup to the economic well being of the country.[26]

While the recent economic gains made in Latin America have served to strengthen their democratic governments, many first generation reforms were enacted by decree and did not enjoy the support of popular institutions such as legislatures or political parties. By contrast continued economic reforms will require the support of the electorate. Because of continued inequities in the distribution of wealth, some of these reforms are now under attack. The challenge for these governments is to maintain their economic growth, while finding means, political and economic, to satisfy the needs of their population.[27] For its part the United States can play a critical role in assuring continued growth and democratic stabilization through expanding trade access to US markets.

FAST TRACK LEGISLATION

After an earlier defeat in his first term, President Clinton again set out to gain renewal of fast track authority in 1997. To many in the Latin American community, passage of this legislation matches words with deeds and provides reassurance of US commitment to the goals of the Summit of the Americas.

Fast track, a key tool in the pursuit of the Free Trade Area for the Americas, gives the President the authority to negotiate trade agreements that require an up or down Congressional vote without the possibility of amendment. Without fast track authority many countries are reluctant to engage in lengthy trade negotiations with executive branch officials, only to have proposed agreements subject to special interest influence in the US Congress.[28] While the necessary preliminary work can be accomplished, fast track is generally viewed as a must for final FTAA negotiations.

In the first visit of his Presidency to South America in October 1997, President Clinton acknowledged that the battle to win fast track authority would be tough, but went on to say he expected to prevail. His comments suggested that the international standing of the United States was at stake.[29] However, only weeks later, the US Congress defeated the measure dealing the President and free trade proponents a substantial defeat.

Congressional opponents defeated the measure by insisting that trade agreements include provisions that would require our trading partners to meet labor and environmental laws nearly as stringent as those required of US companies. Labor unions actively opposed the legislation wanting to mitigate some of the competitive advantage of developing countries that frequently use children in labor intensive industries.[30] Likewise, environmental groups sought to stem the negative environmental effects typically associated with industries in poorer countries.

Proponents of the legislation argued that these are unrealistic standards to require of developing countries and unfairly affected Latin American countries over the industrialized countries of Europe or Asia. Instead, they countered that these reforms would evolve naturally as the benefits of increased trade leads to an improved quality of life.[31]

Another significant factor contributing to congressional opposition to fast track and expanded free trade can be traced to the 1994 devaluation of the Mexican peso. Following the passage of NAFTA and only one week after the Summit of the Americas, the Mexican peso suffered an unexpected and significant meltdown. The net result was the sudden and enhanced competitiveness of Mexican goods traded in the United States. A financial bailout by the United States angered many Congressmen, who had to answer to constituents with protectionist leanings. For those who had originally opposed NAFTA, the crisis simply added to their doubts about the wisdom of the alliance.

Another consequence of the peso crisis was a renewed ambivalence toward Latin American as a whole. Commonly known as the "tequila effect", wary investors and traders expressed concern that the circumstances leading to the Mexican crisis may be present in other Latin American countries.[32]

For their part, free trade proponents in the United States countered that new international trade initiatives that reduce barriers to US exports will be a boon to both the US worker and economy. While 50 million jobs had been created in the past several decades, the median family income of most Americans has remained virtually unchanged and average real wages have remained flat. They countered that the US challenge is to create jobs with higher wages and better benefits.[33]

International trade was put forth as an integral part of the solution to this dilemma. Jobs associated with export industries typically paid 10-15 percent more than average wage. Likewise, productivity was as much as 20 percent higher in export firms. These firms, which tend to be smaller to mid-size companies, also expanded faster and were likely to fail.[34]

With trade at the leading edge of US interaction with other countries in the hemisphere, the defeat of fast track is a serious setback for the United States. With the demise of foreign aid, trade defines our cooperative pursuits with our neighbors to the south.[35] Aside from the detrimental effects on the pursuit of free trade, the United States is likely to find its leverage significantly reduced on other matters of national interest, such as environmental protection and drug trafficking.[36]

THE CASE OF CHILE

The case of Chile highlights the consequences of inaction and a lack of focus on the part of the United States toward hemispheric free trade. With one of the region's strongest economies, Chile has been a leader in pursuing the economic benefits resulting from increased and diversified exports.[37]

After Chile was assured of an invitation to join NAFTA, the necessary steps were not taken to turn the offer into reality. As a result Chile actively sought to negotiate bilateral trade agreements in the region. To date agreements have been concluded with Venezuela and Columbia. In 1996, Chile also negotiated to become an associate member of Mercosur. A Chile-Canada Free Trade Agreement took effect in July 1997 and a preexisting agreement with Mexico is being updated to reflect the provisions of NAFTA.

While the agreements with Canada and Mexico may yet lead to inclusion in NAFTA, the cost to US businesses can be measured in real terms in the present.[38] For example, American wine producers are losing market share in Venezuela to Chilean wineries. Chilean wines are imported tariff-free while American wines carry a hefty 20 percent duty. If tariffs were eliminated, it is speculated the American market share could increase from five to 30 percent.[39] The recent selection of a Canadian firm to provide a $200M telecommunications equipment contract in Chile was due, at least in part, to an additional $20M in duties levied on US competitors.[40] While still wanting to join NAFTA, Chile has made considerable progress toward free trade on its own making the need to join NAFTA less critical to Chilean national interests.

THE ROLE OF BRAZIL

With its vast size and large population, Brazil is a natural leader on economic matters in the southern region of the hemisphere. Despite a turbulent situation during the 1980's, Brazil has recently made some of the region's most significant economic gains. Government owned industries are being privatized and infrastructure development is progressing. Despite being severely affected by the Asian financial crisis late last year, in 1997 Brazil marked its fifth straight year of uninterrupted growth, declining inflation, and an increase in foreign direct investment.[41]

The success of Mercosur has enhanced the position of Brazil in the southern region. Likewise, while leading the effort to aggressively market Mercosur to other regions of the world, Brazil has seized new opportunities to expand its sphere of influence and demonstrate a new level of leadership in the world.

While the relationship between Brazil and the United States is cooperative and constructive, the means to achieve the Free Trade of the Americas are highlighting some of the differences between the two nations. For their part Brazil is resistant to any attempts by the United States to dominate the process or dictate the path. For example, Brazil does not support the use of NAFTA as the basic framework for FTAA.[42] Known as the "hub and spokes" model, Brazil sees the United States at the center while they would be relegated to one of the many spokes. While part of the Brazilian opposition to this approach relates to their own trading patterns within the hemisphere, more significant is Brazil's resistance to being subsumed by the United States in this process.

In his 1997 visit to South America, President Clinton attempted to alleviate Brazilian concerns regarding US dominance. Speaking to President Fernando Henrique Cardosa, the Brazilian President, he stated that America "reaches out to Brazil with a hand of friendship and a pledge of partnership."[43]

Together the Brazilian and US markets offer the largest opportunities for exports from other countries in the hemisphere. As such, these two giants play a critical role in the success of the economic goals of the Miami Summit. Without their commitment and willingness to work toward a common purpose, the Free Trade Area of the Americas is unlikely to be realized.

ECONOMIC MATURITY

Differences between developing and industrialized nations pose some of the most significant challenges to achieving hemispheric-wide free trade. Despite recent Latin American reforms, the United States will likely have numerous concerns entering into the FTAA negotiation phase. For example, widespread judicial and administrative corruption within Latin America leads to concerns regarding fair treatment for U.S. exporters and investors, security of contracts and property, and protection for intellectual property rights. In addition to high tariffs, other nontariff issues will include limits on foreign investment, inadequate patent and copyright enforcement, quantitative restrictions on certain industries, and regulations limiting foreign business service providers.[44]

Because of similar U.S. concerns with regard to Mexico's membership in NAFTA, the final agreement addressed these issues. While NAFTA incorporates the tariff reductions and other features typically associated with trade agreements, it also mandates the modernization of Mexico's legal system and imposes timelines on Mexico to phase out remaining interventionist trade and industrial policies. The agreement also requires follow-on consultations on a wide range of other nontariff issues.[45]

Recognizing the sensitivity of Brazil and others nations concerning US dominance in the FTAA negotiation phase, the United States is still likely to push hard for a wide range of features in the final agreement. To do otherwise would be contrary to U.S. economic interests. The challenge will be to concurrently balance the needs of advanced industrialized countries with realistic expectations for developing countries.

FTAA NEGOTIATION PROCESS

At the most recent ministerial meeting held in Belo Horizonte, Brazil in May 1997, both countries and subregional trading blocs submitted proposals outlining their preferred methods for moving from the preparation phase to the FTAA negotiation process. Consensus was reached on several key issues advanced in these proposals. A joint declaration called for formal FTAA negotiations to be launched at the second Summit of the Americas to be held in April 1998 in Santiago, Chile. Furthermore, countries agreed that the FTAA would coexist with, rather than supersede, existing subregional agreements to the extent that the rights and obligations under these agreements were not covered or went beyond those of the FTAA. The trade ministers also decided that negotiations could be accomplished by individual nations or by groups, such as established subregional trading alliances.[46]

Although the participants reaffirmed their commitment to conclude the trade agreement by 2005, there was disagreement on the pace and direction of formal negotiations. The majority of countries, including the United States, preferred that formal FTAA negotiations commence on all issues in April. Mercosur countries, however, proposed a three-phased negotiation process. They appeared to be alone in their support of a phased approach.[47]

In addition to actions related to the negotiation of the Free Trade Area of the Americas, other related economic integration and free trade items are on the proposed agenda for the Santiago Summit of the Americas. These include capital markets; cooperation on science and technology; regional energy cooperation; and establishment of an adequate hemispheric infrastructure, especially in matters of transportation and telecommunications.

CONCLUSIONS

The commitment of the United States to the cause of hemispheric free trade must have its roots in a comprehensive U.S. foreign policy for the region. As Latin America enters the next century poised to become one of the world's most formidable economic powers, the Unites States has an historic opportunity to forge deep and lasting economic partnerships with these countries. To do otherwise will be to forfeit this opportunity to others who recognize the potential of this region.

While their Latin American hosts graciously welcomed President Clinton and Secretary of State Albright on their recent inaugural visits to South and Central America, the timing of these visits leads to scrutiny of U.S. motives. The history of United States-Latin American relations is replete with examples of "on-again off-again" interest. Lulls in U.S. involvement in the region have come to be known as "benign neglect", while periods of activity have often involved interventions that were directive in approach and paternalistic in tone.

The recent focus on hemispheric concerns will appear to have followed this same historical pattern should recent diplomatic attention subside after the Summit of the Americas and the United States then attempts to dictate the terms of the FTAA negotiations. Forging the Free Trade Area of the Americas into reality will require new ways of dealing with our hemispheric neighbors. The leadership role for the United States is to shape and frame the process through dialogue and constructive debate. This will require a balance between the pursuit of U.S. interests and recognition of the unique realities confronting other countries.

The "on-again off-again" approach mentioned above also ensures that the U.S. media largely ignores Latin American issues. While the well-read American may be exposed to regional issues, the average citizen must rely on sound bytes on the evening news for current events coverage as well as perspective and focus. A concerted effort to provide thoughtful coverage on the region could go a long way toward generating interest in regional issues and understanding of their relationship to U.S. interests.

Besides the lack of exposure to the region by most Americans, other less agreeable rationale for U.S. ambivalence to its own hemisphere needs to be considered. These range from outright prejudice to mere condescension. To overcome stereotypes and misinformation enhanced coverage of the region and its importance to the economic future of the United States is critical.

The United States must also promote the importance of free trade to its own populace. As an example, most Americans acquired their current understanding of NAFTA from the campaign advertisements and political rhetoric leading to the 1996 presidential election. The effects of NAFTA on the U.S. economy and the American worker were largely distorted for political considerations. To stem the tide of misinformation, a concerted effort to provide the facts to American citizens before the next presidential campaign is essential.

The importance of fast track to the realization of the Free Trade Area of the Americas cannot be overstated. While the current preparations phase has progressed well, at some point the participation of the United States in the FTAA negotiations phase will stall if presidential fast track authority is not renewed. Opponents of free trade can be expected to marshal their forces early and effectively as they did in last year's defeat. While the President reaffirmed his intention to pursue the authority again in his State of the Union address in January, words will not be enough. He must rally the supportive forces in the Congress, business and other influential quarters to overcome the earlier defeat. Likewise, the effort needs to begin well ahead of the projected vote to build the necessary coalition of support from a group with typically divergent interests.

The approach of the new millenium presents the United States with a historic opportunity to reflect on the lessons of this century and plan anew for the next one hundred years. The question that remains is whether at the close of the next century the United States will have capitalized on the current momentum for economic integration and expanded free trade or squandered a remarkable opportunity?

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