

# CRS Report for Congress

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

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### Summary

At the second Summit of the Americas in Santiago, Chile (April 1998), 34 Western Hemisphere nations agreed to initiate formal negotiations to create a Free Trade Area of the Americas (FTAA) by 2005. The process so far has led to two draft texts, with a third draft expected to be completed for the eighth trade ministerial scheduled for November 17-21, 2003 in Miami. Currently there are serious differences between Brazil and the United States, the co-chairs of the trade negotiating committee, which will need to be resolved by then. Although implementing legislation is not anticipated until the next Congress, for an FTAA to be signed in January 2005, the 108<sup>th</sup> Congress will play a crucial role during this last phase of the negotiations given its expanded consultative and oversight authority as defined in the Trade Promotion Authority (TPA) provisions of the Trade Act of 2002 (P.L. 107-210). This report will be updated periodically.

### Background and Status of Negotiations

Over the past two decades, trade liberalization and broader economic policy reform in Latin America have raised the prospect of a previously unlikely idea – a Free Trade Area of the Americas (FTAA) involving 34 nations of the Western Hemisphere. Latin America’s approach to freer trade, referred to as “open regionalism,” has involved the creation of sub-regional agreements, some of which are open to new members and whose members remain free to pursue other agreements. Examples include: the North American Free Trade Agreement (NAFTA); the Southern Common Market (Mercado Común del Sur – Mercosur); the Andean Community (AC); and the Central America Common Market (CACM). These arrangements, along with numerous bilateral agreements and unilateral trade liberalization decisions, have reduced average tariff rates in Latin America from over 40% in the mid-1980s to under 12% by 2000, and doubled trade openness, as measured by imports rising from 10% to 20% of gross domestic product (GDP).<sup>1</sup>

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

Many see the FTAA as the next important step for Latin American trade opening and an essential element of an export-led development strategy. Trade-related development, however, requires more than simple export growth. It is through access to larger export markets, higher quality, lower-priced capital goods, and foreign capital investment that economies can develop manufacturing bases to diversify export earnings away from dependence on price-volatile commodity trade. For example, Latin America's trade has grown faster than the world average over the last decade, yet these countries have been slow to diversify their export base into manufactured goods, particularly to markets outside the region. The exceptions are Mexico and Central America, which have experienced export-diversifying trade creation by participating in closer trade and investment arrangements with the United States. The United States also is Brazil's largest market for value-added manufactured products. FTAA advocates argue that broader and deeper regional integration that includes the U.S. market could spur diversified export development in many other Latin American countries, as well.<sup>2</sup>

Despite the benefits of Latin America's trade liberalization, the multitude of free trade agreements (FTAs) that "open regionalism" has spawned can also lead to inefficient and discriminatory trade. The impetus to correct this situation, combined with the conviction that trade liberalization is a cornerstone for reform and development, has generated widespread official support for the FTAA, although skeptical attitudes prevail as well. This includes the United States, which acknowledges its growing trade relationship with Latin America, and the potential for the FTAA to support broader U.S. goals in the region such as promoting democracy, regional security, and drug interdiction efforts. But, these goals must be reconciled with interests of import competing industries, as well as those of labor and environment groups. Still, an FTAA is expected to reduce barriers to trade region wide, allowing all countries to trade and invest more with each other under the same rules. Defining those "rules," however, is no small task.

Writing the FTAA agreement falls to nine negotiating groups responsible for: market access; agriculture; investment; services; government procurement; intellectual property rights; subsidies, antidumping, and countervailing duties; competition policy; and dispute settlement. The 34 countries committed to accept all parts of the agreement in the end, known as the single undertaking provision. Each group is chaired by a different country and the overall process is directed by the Trade Negotiations Committee (TNC). The TNC chair has rotated every 18 months or following a trade ministerial meeting, as have chairs of the various negotiating groups. In addition, there is a consultative group on smaller economies, a committee on civil society to provide input from non-government parties (labor, academia, environmental groups), a technical committee on institutional issues, and a joint government-private sector committee of experts on electronic commerce. Draft FTAA texts reflect the input of all countries, and in some cases groups of countries such as Mercosur, with "bracketed text" reflecting areas of disagreement. In an unprecedented nod to transparency in the trade negotiating process, the draft texts are being released upon completion in all four official languages.<sup>3</sup>

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<sup>2</sup> Ibid., pp. 12-15 and Weintraub, Sidney. *Development and Democracy in the Southern Cone*. Center for Strategic and International Studies, Washington, D.C., February 2000. pp. 12-13.

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

Since 1994, there have been three summits and seven trade ministerial meetings. Trade ministers approved the first draft of the FTAA at the April 5-7, 2001 ministerial in Buenos Aires and it was adopted by the countries at the Quebec City Summit three weeks later.<sup>4</sup> Additional goals were achieved at the Quito ministerial in November 2002: 1) the second draft of the FTAA agreement was approved and released; 2) Brazil and the United States became co-chairs of the TNC and will guide the negotiating process through its final phase to expected completion in January 2005; 3) a new Hemispheric Cooperation Program (HCP) was established to develop resources to help small countries “strengthen their capacity to implement and participate fully in the FTAA;” 4) a time line was established for the critical market access negotiations; and 5) the final rotation of chairs for the various negotiating groups was completed. The eighth FTAA ministerial meeting will convene on November 17-21 2003 in Miami, Florida, where a third draft text of the agreement is expected to be presented.

The most important recent milestone, reiterated at the April 2003 TNC meeting, was the initiation of detailed market access negotiations involving five separate negotiating groups: market access; agriculture; services; investment; and government procurement. They were given instructions to coordinate their efforts in developing guidelines and chapter revisions, and final revised offers for all market access issues are due by July 15, 2003. The ministerial declaration also formally affirmed that discussions on agriculture, a critical and sensitive topic for most countries, will have to be done with an eye on parallel discussions being undertaken by the World Trade Organization (WTO). The WTO deadline for agriculture negotiations is also set for January 2005.

## Major Negotiation Issues

The FTAA involves a commitment by 34 countries to consider a broad trade policy agenda, and although there is much work to be done, major milestones were achieved in 2002. First, when the U.S. Congress passed trade promotion authority (TPA) as part of the Trade Act of 2002 (P.L. 107-210), it removed one major barrier to the FTAA’s completion, particularly from the Latin American perspective. This provided the Bush Administration with guidance on trade negotiations, which if followed, should improve chances that a final agreement will win congressional approval under expedited procedures. To begin fulfilling the new congressional consultation requirements defined in the TPA statute, the USTR’s office formally notified Congress on October 4, 2002 of the Bush Administration’s FTAA negotiation objectives.

Second, the election of Luiz Inacio Lula da Silva as President of Brazil settled another important political question given that Brazil is a key player on many of the issues that must be resolved. Third, the FTAA negotiations entered their final phase after the Quito Ministerial. Much still lies ahead, however, and if an agreement is to be reached by 2005, which is still uncertain in the minds of many representing some of the smaller Caribbean countries as well as Brazil, the most difficult challenges will have to be addressed during the 108<sup>th</sup> Congress. The major policy issues are outlined below.

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<sup>4</sup> Summits of the Americas took place in Miami (1994), Santiago (1998), and Quebec City (2001). Trade ministerial meetings were hosted in Denver (1995), Cartagena (1996), Belo Horizonte (1997), San Jose (1998), Toronto (1999), Buenos Aires (2001), Quito (2002), and will be followed by Miami (November 17-21, 2003).

**Market Access and Trade Remedy Issues.** The negotiating committee on market access faces one of the most difficult challenges, particularly given that the two largest regional economies, Brazil and the United States, have different priorities. The United States, along with Canada, has the lowest average tariff rate in the Western Hemisphere of 4.5%.<sup>5</sup> But Brazil and other countries argue that many of their exports are subject to U.S. tariff rate quotas (TRQs) and their related high peak tariffs, as well as countervailing duty and antidumping actions. Brazil, by contrast, has much lower peak tariff rates, but has the second highest average regional tariff rate of 14.3% and relies on other trade barriers, as well. The United States has focused its negotiation position on reducing overall tariff rates as the primary goal in market access discussion, but its specific offer differs significantly from what Brazil proposes (see next section).

Latin American countries, by contrast, are pressing to address U.S. trade remedy laws, domestic support for farmers, and peak tariff rates, with Brazil specifically focused on opening the U.S. market further to its agricultural, steel, and textile exports. Specific instructions were also given in Quito to the agriculture negotiating group. For many Latin American countries, agricultural exporting is critical for their economic well being and they consider tackling U.S. agricultural trade policies, particularly subsidies, central to any discussion on market access. Many agricultural interest groups in the United States have made clear, however, that they are uninterested in negotiating an agricultural subsidies agreement that does not include Europe and Japan, hence the importance of the parallel negotiation with the WTO.<sup>6</sup>

**Other Trade Barrier Issues.** Services trade is another vital issue for the United States given its competitive strength in such areas as financial services, transportation, engineering, and technology consulting. Beyond market access, there are issues critical to the United States that will take center stage, if the recently signed U.S.-Chile FTA negotiation is any indication. Intellectual property rights (IPR), government procurement, and competition policy are among the most important. Intellectual property rights violations have hurt U.S. producers throughout the world and few countries have laws protecting intellectual property to the extent the United States does. Copyright issues and protection of digital products are among the more important issues to resolve. This proved difficult to resolve in the Chile bilateral agreement and may also require extensive discussion to change laws in over 30 other countries. Competition policy is another difficult area because of the need to standardize approaches regulating domestic economic activity, although it may prove more easily reconcilable than IPR disagreements.

**Labor and Environment Provisions.** Another contentious issue is language covering labor and environment provisions. Developing countries have often resisted these provisions, arguing that they should be left to domestic governing authorities or the relevant international organization, may be difficult for developing countries to meet, and can be used for protectionist purposes. Concern from the developed world, on the other hand, is that different standards among trading countries may provide competitive advantages or disadvantages (lower or higher costs to produce). Specifically, the concern

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<sup>5</sup> 1999 unweighted average Most Favored Nation (MFN) applied tariff rates reported in: Inter-American Development Bank, *Integration and Trade in the Americas*, December 2000, p. 125.

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

goes to ensuring that lower environmental or labor standards in developing countries not become a basis for exploitive, lower-cost exporting, or serve to attract foreign capital investment, and that higher standards, as in the United States, not be challenged as disguised barriers to trade. Environmental advocates also point to the social impact of failure to enforce pollution abatement and resource management laws.

NAFTA set a precedent for including labor and environment provisions in trade side agreements, an approach also adopted in the 1997 Canada-Chile FTA. Since then, the debate has intensified and has turned on where the language should be placed in the agreement, the specificity of the provisions, and how dispute resolution will be handled. A key reference point is the U.S.-Jordan FTA, which incorporated labor and environment provisions into the text of the agreement and provided for a single dispute resolution mechanism for both commercial and social issues. The wording emphasizes that each country will be held accountable for enforcing its own laws, will reaffirm its commitments to basic United Nations International Labor Organization (ILO) labor standards, and not diminish its standards as a way to pursue trade and investment opportunities. Trade sanctions, although not expressly called for, are also not excluded as a possible form of dispute resolution in the Jordan agreement.

For many in the United States and Latin America, these provisions were too strict. The precise location of labor and environment language in the FTAA is less controversial than other aspects. By contrast, staunch resistance arose over the use of trade sanctions as a possible remedy for noncompliance with labor or environment provisions. In the U.S.-Chile FTA, language calls for fines or “monetary assessments” to address noncompliance, with a recourse to loss of trade benefits as a way to collect unpaid fines. Labor advocates have expressed dissatisfaction with the U.S.-Chile FTA, however, because it steps back from the U.S.-Jordan agreement by having dispute resolution expressly apply only to language upholding domestic labor laws, leaving reaffirmation of ILO standards and “non-derogation” from domestic standards uncovered. This issue, however, hinges on one’s interpretation of congressional intent of negotiating objectives, as written in the TPA, which the USTR argues it has met in the Chile agreement. The monetary assessment is also questioned as a “meaningful deterrent” for various reasons, which is also disputed by the USTR.<sup>7</sup> Given the continuing debate over labor and environment language, the issue appears to remain open with respect to the FTAA.

## **Outlook: The U.S.-Brazil Nexus**

The United States and Brazil are tied together in the FTAA process as the co-chairs of the TNC. As the two largest regional economies with perhaps the most divergent perspectives on the FTAA, it is logical that resolving their differences will be a central hurdle to meeting the January 2005 deadline. Although both countries reiterated their commitment to meeting this deadline in a mini-ministerial conducted June 13, 2003, and at a meeting between Presidents Bush and Lula one week later, there appears to be

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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>].

considerable difference in what they expect to accomplish. In fact, the two countries may be contemplating significantly different notions of an FTAA.

Brazil has taken a firm stand against three U.S. trade policy initiatives. The first is the U.S. strategy of pursuing subregional trade arrangements. In particular, Brazil sees NAFTA, the Andean Trade Promotion Act (ATPA), the Caribbean Basin Initiative (CBI), and bilateral agreements under consideration with Chile and Central America as having an isolating effect on the Mercosur countries, and especially Brazil.

Second, the United States has insisted it cannot deal with agricultural subsidies in the FTAA, preferring instead to negotiate them in the Doha Round of the WTO in order to include the major subsidizing countries (the European Union and Japan, among others). The United States has also decided that antidumping should be negotiated in the WTO, presumably because of congressional opposition, which Brazil considers to be a conflict with the FTAA's single undertaking provision.<sup>8</sup> Third, the United States is insisting on a "differentiated access" approach to market access. The USTR market access offer calls for 65% of imports from Latin America to be given duty free treatment immediately, but there would be different tariff elimination timetables "to reflect different sizes and levels of development of the economies." With respect to U.S. consumer and industrial imports, immediate duty-free treatment would apply to the following percentages of goods based on their subregion of origin: 1) Caricom-91%; 2) Central America-66%; 3) Andean-61%; and 4) Mercosur-58%. A similar schedule is offered for agricultural products. Brazil in this case would qualify for the least preferential schedule, although it would still represent improved market access.

Brazil considers the U.S. strategy discriminatory and responded with its own approach, referred to as the "Three Track Proposal." The Brazilian offer would: 1) have the United States conduct market access discussions with the Mercosur countries, known at the "4+1" arrangement; 2) allow investment, government procurement, and IPR issues to join agricultural subsidies and antidumping at the Doha WTO round; and 3) include the remaining rules-based issues in the FTAA discussions. This would include rules of origin, some disciplines on investment, competition policy, and other issues not dealt with elsewhere. Brazil considers its offer as mirroring a United States trade policy strategy that Brazil characterizes as selectively using the FTAA to negotiate its best deal. The United States has not agreed to such a proposal, arguing that it effectively amounts to an alternative negotiation to the FTAA process.

President Lula's visit with President Bush on June 20, 2003 resulted in an apparent mutual understanding reaffirming that the FTAA would be completed by January 2005, and that a number of special bilateral consultative committees would be formed to address critical issues, such as agriculture. Major differences between the two countries remain over how the FTAA negotiations should proceed, however, and bridging the gap by the November 2003 trade ministerial in Miami would seem to be necessary if the FTAA is to achieve its January 2005 completion deadline.

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<sup>8</sup> The USTR, in its summary of the "most important" FTAA negotiating principles in its *Trade Policy Agenda and Annual Report*, has always emphasized two points: improving upon WTO rules and disciplines, and the outcome being a single undertaking. Interestingly, the single undertaking language was dropped in the 2003 report.