The Heritage Foundation Backgrounder

No. 1092 The Heritage Foundation • 214 Massachusetts Avenue, N.E. • Washington, D.C. 20002-4999 • (202) 546-4400 • http://www.heritage.org

September 25, 1996

RESTORING AMERICAN LEADERSHIP IN LATIN AMERICA AND THE CARIBBEAN

INTRODUCTION

Latin America has bounced back from the economic meltdown caused by the Mexican peso on December 20, 1994, but the United States has not. The democracies of Latin America have stayed on course with free-market reforms, trade liberalization policies, and efforts to create a Free Trade Area of the Americas (FTAA). However, the U.S. appears to have turned its back on Latin America. As free trade has faded from the foreign policy agendas of both the Clinton Administration and the 104th Congress, U.S. relations with Latin America have deteriorated significantly. On issues such as Cuba, drug trafficking, illegal immigration, and even the creation of the FTAA, America today is increasingly at odds with important hemispheric trading partners such as Canada, Mexico, Brazil, Argentina, Chile, and Colombia.

America's flight from enlarging the North American Free Trade Agreement (NAFTA) has damaged U.S. leadership and economic interests in the Western Hemisphere, but hemispheric trade expansion has not been interrupted. Mexico has signed free trade agreements (FTAs) with Chile, Bolivia, and Costa Rica, is negotiating its association with the South American Common Market (Mercosur),[1] and soon will launch trade negotiations with the European Union. Chile recently became an associate of Mercosur and is negotiating a bilateral FTA with Canada. Other countries interested in joining Mercosur include the five members of the Andean Community.[2] Mercosur also wants to sign an FTA with the European Union. Clearly, no one is waiting for America to climb back aboard the free trade express in the Western Hemisphere.

1 The acronym for the South American Common Market is Mercosur (Spanish) or Mercosul (Portuguese). The group's founding members include Brazil, Argentina, Paraguay, and Uruguay.

2 The members of this group, formerly called the Andean Pact, include Venezuela, Colombia, Peru, Ecuador, and Bolivia.

From 1980-1992, the Reagan and Bush Administrations established the closest and strongest relationship with Latin America that the U.S. has enjoyed in more than a century. The bases of this new hemispheric partnership were democracy and the creation of a hemispheric free trade area, as provided for in the Enterprise for the Americas Initiative (EAI) and the NAFTA.

But since 1993, the Clinton Administration has dissipated the achievements of more than a decade by pursuing a policy of neglect and indifference toward Latin America. Since the collapse of the Mexican peso at the end of 1994, NAFTA has become a political football for politicians who claim that free trade is the cause of such domestic problems as increased drug trafficking and illegal immigration. Instead of responding by making a strong case for NAFTA, however, some previously strong supporters of free trade have scaled back their support for its enlargement, and for the FTAA process in general. America's retreat from NAFTA's expansion is hurting American consumers and workers, undermining U.S. economic interests in Latin America, and weakening U.S. leadership in the Western Hemisphere.

If this situation is not reversed, U.S. interests in Latin America could suffer lasting damage. To regain America's leading role in the FTAA process and heal the recent rifts in U.S. relations with Latin America, the U.S. Administration should:

- ✔ **Approve a new fast-track negotiating authority.** Without fast-track, U.S. participation in and influence at the third post-Summit of the Americas Trade Ministerial, to be held during the second quarter of 1997 in the Brazilian city of Belo Horizonte, will be marginal at best.
- ✔ **Expand NAFTA during 1997 to include Chile.** The accession of Chile to NAFTA would reaffirm America's commitment to an FTAA with Latin America and the Caribbean, open a new gateway for U.S. exports in South America and the nations of the Asia Pacific Economic Cooperation forum (APEC), and provide America with valuable strategic leverage in future convergence talks with Mercosur.
- ✔ **Include the Caribbean Basin Initiative (CBI) countries in NAFTA.**[3] H.R. 553, stalled in Congress since 1995, would improve market access for U.S. exports to Caribbean and Central American markets. It also would require CBI beneficiaries to strengthen rules relating to investment, labor standards, and the environment, among other improvements that strongly favor U.S. interests.
- ✔ **Launch a dialogue to integrate NAFTA and Mercosur.** The goal of such talks should be to deepen and harmonize trade disciplines between NAFTA and Mercosur

3 The Caribbean Basin Economic Recovery Act (CBERA), better known as the Caribbean Basin Initiative (CBI), was passed by the U.S. Congress in 1983 and implemented largely during 1984. The CBI provides beneficiary countries duty-free access to the U.S. market for all products not excluded by law. The 24 countries, territories, and successor political entities which currently receive CBI benefits include Aruba, Antigua and Barbuda, Barbados, Belize, British Virgin Islands, Costa Rica, Dominica, the Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, the Netherlands Antilles, Nicaragua, Panama, St. Christopher-Nevis, Saint Lucia, Saint Vincent and the Grenadines, and Trinidad and Tobago.

as both groups take on new members; the ultimate objective should be to merge these two regional groups into a single hemispheric FTAA by 2005.

- ✔ **Define a pathway and timetable for creating the FTAA.** Western Hemisphere nations should define quickly whether the FTAA will include commitments that go beyond those already made in NAFTA and the World Trade Organization (WTO). America should insist on FTAA trade disciplines that improve on NAFTA and the WTO.

- ✔ **Implement reforms that do not require negotiations,** including unilateral cuts in tariff and non-tariff barriers to trade, simplification and harmonization of existing rules and regulations affecting the flow of goods and services in the region, removal of barriers to trade in services, enactment of world-class protection for intellectual property rights, and revision of investment regulations.

- ✔ **Establish separate negotiations on issues unrelated to free trade,** such as drug trafficking, corruption, illegal immigration, labor standards, and preserving the environment. The action plan approved at the Summit of the Americas on December 11, 1994, outlines such a framework; in practice, however, the Clinton Administration has sought consistently to establish conditions and linkages between free trade and other issues. As a result, tensions between the U.S. and Latin America have increased in the past two years, and U.S. leadership and credibility have suffered.

- ✔ **Negotiate FTAs with New Zealand, Singapore, and Australia.** The negotiation of bilateral free trade agreements with these countries could create momentum for the convergence of the FTAA and APEC processes into a single free trade area encompassing more than 2 billion consumers.

- ✔ **Convene a second Summit of the Americas in 1997.** Strong leadership is required to prevent regionalism from derailing the FTAA process. The goals of a second Summit of the Americas should include creation of a WTO-type entity to advance negotiations, expansion of FTAA technical working groups to propose policies and specific actions, and a commitment by all democracies in the Western Hemisphere to a specific timetable and pathway for launching the FTAA by 2005.

- ✔ **Dismantle domestic U.S. barriers to free trade.** U.S. protectionism is the greatest impediment to free trade and creation of an FTAA. Overall, congressionally mandated protection and managed trade policies cost American consumers over $70 billion a year and encourage U.S. trading partners to retaliate with measures that hinder free trade and penalize American consumers and exporters.[4]

4 Joseph E. Pattison, *Breaking Boundaries: Public Policy vs. American Business in the World Economy* (Princeton, N.J.: Peterson's/Pacesetter Books, 1996), p. 55.

TRADE POLICY BLUNDERS IN LATIN AMERICA

The greatest failure of U.S. Latin American policy in recent years has been in the area of trade policy. The U.S. no longer leads the Western Hemisphere FTAA process, primarily because the Clinton Administration has chosen to retreat from free trade and NAFTA's enlargement rather than defend the trade pact's record of success. As a result, the FTAA process has lost momentum and the U.S. has surrendered leadership and negotiating advantage to Brazil, which has tilted the FTAA process toward the enlargement of Mercosur into a South American Free Trade Area (SAFTA) centered on Brazil and capable of challenging U.S. economic interests and leadership in the Americas.

This retreat from free trade is severely damaging to U.S. relations with Latin America, not to mention economic and security interests in the Western Hemisphere. Without the goodwill and greater economic interaction that come with increased trade and investment, it will be more difficult for the U.S. and Latin America to develop and implement effective policies for managing such hemispheric problems as drug trafficking, corruption, illegal immigration, and environmental destruction. Moreover, Washington's reluctance to expand NAFTA means that American companies and workers risk missing out on the fast-paced trade expansion occurring today throughout Latin America. Opportunities missed by U.S. companies will be seized by investors from other countries. Exports, jobs, and wealth creation possibilities lost in Latin America by U.S. firms will accrue to others.

NAFTA: TWO YEARS OF SOLID GROWTH

Since the peso's collapse on December 20, 1994—only nine days after the Summit of the Americas concluded in Miami—critics of NAFTA have been claiming that the trade pact is a failure. Many critics also blame NAFTA for the growing problems of drugs, illegal immigration, and declining real wages in U.S. manufacturing. But NAFTA did not cause the Mexican peso crisis and is not responsible for America's social problems. Moreover, far from being a failure, NAFTA has scored some impressive trade and investment successes during its first two years.

NAFTA helped Mexico overcome the peso crisis. The international obligations created by NAFTA and by Mexico's membership in the Organization for Economic Cooperation and Development (OECD) enabled the embattled government of Mexican President Ernesto Zedillo to rebuff intense political pressure to roll back Mexico's economic reforms after the peso collapsed. As a result, the Mexican economy now is recovering from the crisis, although years will pass before per capita income returns to pre-peso crisis levels.

During NAFTA's first two years, trade and foreign direct investment among the U.S., Mexico, and Canada have increased. Since 1994, the average U.S. tariff on Mexican products has fallen from 3.5 percent to 1.5 percent, while average Mexican tariffs on U.S. products have dropped from 10 percent to 4.9 percent. As a result, trade among the three NAFTA countries rose by 17 percent in 1994 to $350 billion, and bilateral U.S.-Mexico trade grew by 20.7 percent, surpassing $100 billion for the first time.

In 1995, despite the recession caused by the peso's collapse, overall U.S.-Mexico trade increased 8 percent to $108 billion, while total intra-NAFTA trade grew 10.6 percent to $380 billion.[5] Moreover, after declining by 8.9 percent in 1995 to $46.3 billion, U.S. exports to Mexico increased by 12.1 percent during the first three months of 1996, compared with the same period in 1995.[6] More than 75 percent of all U.S. states reported a rise in exports to Mexico during the first quarter of 1996.[7]

The U.S. trade deficit with Canada and Mexico during 1995 totaled $33.49 billion, compared with a 1994 trade deficit of $14.69 billion with Canada and a trade surplus of $1.34 billion with Mexico. Critics have used these figures to defend their claim that NAFTA is costing jobs in America. The reason Mexico imported fewer U.S. goods in 1995, however, is simply that the peso's collapse reduced the buying power of the Mexican people by more than 50 percent, and poorer people buy fewer goods. Americans consumed more Mexican products in 1995 because the average American is much wealthier than the average Mexican. The truth is that more jobs in America today rely on imports than exports, since nearly 90 percent of American manufacturers utilize imported materials or components in their production.[8] Moreover, the $80 billion jump in three-way trade during the first two years of NAFTA's implementation added over 1.6 million new jobs to the North American economy.

NAFTA is restructuring the North American economy as firms in the U.S., Mexico, and Canada create cross-border enterprises that lower manufacturing costs, improve productivity, and expand the volume and diversity of products at lower prices for consumers in all three countries. A recent study by the U.S. International Trade Commission (ITC) found that half of Mexico's total exports to the U.S. are manufactured by U.S.-owned firms, or by production-sharing partnerships[9] whose products have an average U.S. content of 50.2 percent, compared with 35.3 percent for Canada, 32 percent for Taiwan, and 27.8 percent for Korea. As the output of Mexico-based co-production ventures increases, the volume and value of U.S.-made inputs imported by Mexican firms also increase, creating more jobs in America. Moreover, the rise in U.S.-Mexico co-production ventures is diverting investment away from alternative co-production sites in Asia. In 1994, Mexico was America's largest production-sharing partner, accounting for $22.9 billion, or 39.1 percent of all U.S. co-produced imports.[10] U.S.-Mexico production partnerships increasingly play a prominent role in such key industries as motor vehicles, auto parts, computers, televisions and other electrical products, and textiles and apparel, among others.

5 Office of the U.S. Trade Representative, 1996 National Trade Estimate. Appendix: U.S. Data for Given Trade Partners in Rank Order of U.S. Exports.

6 Massachusetts Institute for Social and Economic Research (MISER).

7 "Mexico Recovery Spurring Strong U.S. and Mexican Export Growth in 1996," *NAFTA Works*, Issue 6, June 1996, published by Embassy of Mexico, Washington, D.C., pp. 1-2.

8 Pattison, *Breaking Boundaries*, p. 31.

9 Production-sharing partnerships perform different parts of the manufacturing process in different countries to improve production efficiencies and enhance competitiveness.

10 U.S. International Trade Commission, "Production Sharing: Use of U.S. Components & Materials in Foreign Assembly Operations, 1991-1994," May 1996.

NAFTA Aiding Mexico's Recovery. Only 18 months after the peso's collapse, the Mexican economy is showing signs of a promising, if uneven, recovery. Following five consecutive quarters of decline, the Mexican economy grew sharply during the second quarter of 1996 as real gross domestic product (GDP) rose 7.2 percent compared with the second quarter of 1995. For all of 1996, Mexico is expected to grow about 3 percent, compared to a contraction of 6.9 percent in 1995.[11] Moreover, despite a 22 percent rise in the peso against key currencies during the first seven months of 1996, Mexican exports of manufactured goods have gained 22.8 percent, while imports have increased 22.1 percent.[12] Nevertheless, about 70 percent of all economic activity in Mexico is tied to the domestic economy, which may not feel the overall, export-driven economic upturn for at least another year.

Political and social instability have increased in Mexico as a result of the economic crisis, the spread of drug trafficking, a weak judiciary incapable of fighting corruption, and entrenched political and economic dinosaurs that continue to block democratic reform and true economic freedom. However, NAFTA is not responsible for Mexico's current social and political difficulties. In fact, NAFTA has provided Mexico with a strong anchor and a stable point of institutional reference on the road to true capitalist democracy. Meanwhile, there is reason to be optimistic about Mexico's political future.

Impressive Growth in U.S.-Canada Trade. Canadian exports to the U.S. and Mexico have risen impressively since NAFTA was implemented. Foreign investment in Canada from all sources also has increased significantly. In 1995, two-way trade between the U.S. and Canada grew nearly 12 percent to $272 billion, while total foreign direct investment in Canada increased by 10 percent to $168 billion. The U.S. is the largest foreign investor in Canada. Direct investment in Canada by American firms increased by 11 percent to $113 billion in 1995, representing 67 percent of total foreign direct investment in Canada. Similarly, the U.S. remains the destination for the largest share of Canadian foreign direct investment, with a total of $76.5 billion invested.[13]

Canada's exports in 1994 represented 30.1 percent of its total GDP, compared to 21.6 percent in 1991. Canada's strong export performance during the 1990s was closely related to the growth in Canadian exports to the U.S., and Canadian production of goods for international markets is closely linked to the U.S. through the intra-firm trading of U.S.-controlled firms operating in Canada.[14] Transactions between related firms account for 57 percent of Canadian exports to the U.S., and 72 percent of exports by U.S.-controlled Canadian firms are related-party transactions. According to one survey, "U.S.-controlled [multinational companies] are responsible for the largest share of sales by the Canadian manufacturing and wholesale firms studied, and account for the largest share of their imports and exports." Overall, the Canadian economy is "linked intra-regionally to the U.S. economy."[15]

11 Craig Torres, "Mexico Reports a Surge in Growth for Second Quarter," *The Wall Street Journal*, August 20, 1996, p. A7.

12 Craig Torres and Joel Millman, "Mexico's Exports Gain a Solid Footing," *The Wall Street Journal*, August 22, 1996, p. A8.

13 Official Canadian Trade Ministry figures.

14 Statistics Canada, Ottawa, Canada, April 24, 1996.

A Hemispheric Free Trade Emporium. When Mexico defaulted on its external debt obligations in 1982, it triggered the Latin American debt crisis and plunged the region into a decade of negative growth and falling per capita income. However, when the Mexican peso collapsed in December 1994, Latin America was hardly affected. Economic growth in Latin America and the Caribbean slowed to 0.8 percent in 1995 as the effects of the Mexican peso crisis rippled through the region's financial markets. However, U.S. exports to Latin America and the Caribbean rose to $102 billion in 1995, up 12 percent from 1994 and 72 percent higher than total U.S. exports to the region in 1990. Although individual countries such as Argentina, Colombia, and Mexico are struggling to resolve diverse economic, political, and social difficulties, the region overall has shrugged off the aftershocks of the Mexican peso crisis.

The World Bank predicts that Latin America and the Caribbean will grow by 3.1 percent in 1996 and 4 percent in 1997, with Chile leading the region at 6.5 percent this year while Venezuela lags at 0.5 percent.[16] The bank also predicts that average GDP growth should rise to 3.8 percent in 1996-2005, compared to average growth of 2.4 percent during the past decade.[17] Free trade and foreign direct investment are driving the region's growth. Latin America's exports and imports increased rapidly as tariff barriers dropped from 50 percent a decade ago to 12 percent in 1993, one year before NAFTA went into effect. For years, U.S. exports to Latin America have increased twice as rapidly as exports to any other region of the world. Intra-regional trade between Latin American countries and trade with Asia also are growing rapidly. For example, intra-Mercosur trade doubled in four years to $15.8 billion and today accounts for 22 percent of the group's total world trade, up from 14.3 percent in 1992.

Some World Bank economists believe that Latin America can achieve annual growth rates of 6 to 6.5 percent within a decade if governments in the region raise exports significantly by avoiding overvalued exchange rates; increasing investments for infrastructure such as roads, ports, and telecommunications; and attracting larger amounts of foreign direct investment.[18] However, while democracy, hemispheric economic integration, and trade expansion are progressing rapidly, Latin American and Caribbean countries are still struggling to resolve a host of structural impediments to faster growth and greater stability and economic prosperity. Economic reforms have not advanced sufficiently anywhere in the region, including Chile, which is routinely hailed as Latin America's star performer. The widespread absence of economic freedom is reflected in the region's high levels of poverty, illiteracy, and illegal immigration. Judicial systems are generally weak, politicized, and corrupt. Effective legal protection for individual property rights does not exist. Moreover, drug traffickers have emerged in the 1990s as major threats to the stabil-

15 "Canada's Export Performance Closely Linked to U.S. Economy, Study Shows," *International Trade Reporter*, Vol. 13, No. 17 (May 1, 1996), pp. 723-724.

16 "Latin America Urged to Cooperate with Private Sector, Avoid Populism," *International Trade Reporter*, Vol. 13, No. 28 (July 10, 1996), p. 1145.

17 "World Bank Says Despite Good Prospects, Too Many Developing Countries Lag," *International Trade Reporter*, Vol. 13, No. 19 (May 8, 1996), p. 753.

18 Shahid Javed Burki and Sebastian Edwards, "Dismantling the Populist State: The Unfinished Revolution in Latin America and the Caribbean," The World Bank, Washington, D.C., 1996.

ity of countries such as Colombia and Mexico. Organized violence by subversive guerrilla organizations is increasing in Colombia, Peru, and Mexico.

The difficulties confronting Latin America and the Caribbean today defy easy or quick solutions. They represent both a daunting challenge to the region's expectations for a brighter economic future and a threat to U.S. economic and national security interests. The Enterprise for the Americas Initiative, NAFTA, and Free Trade Area of the Americas were proposed by the U.S. as the foundations of a hemispheric partnership and a new American Century based on democracy, free trade, and the economic integration of the U.S. and Latin America. This vision has not been realized. Nine days after the FTAA was launched at the Summit of the Americas in Miami, the Mexican peso collapsed and the U.S. retreated from NAFTA's enlargement.

TEN INITIATIVES FOR RESTORING U.S. LEADERSHIP TO THE FREE TRADE AREA OF THE AMERICAS

The failure to enlarge NAFTA to involve Chile and the Caribbean countries during 1995 was a major setback for U.S. economic and security interests in Latin America and the Caribbean. The momentum and direction of the FTAA process have changed significantly since the Mexican peso crisis. Brazil has filled the vacuum in the FTAA process created by America's retreat from free trade, and has won regional support for an alternative trade agenda that sidelines a NAFTA/WTO-plus process to create the FTAA in favor of a more limited regional approach based on the expansion of Mercosur to create a South American Free Trade Area (SAFTA) centered on Brazil. Brazil also favors negotiating a trade pact with the European Union before engaging the U.S. in talks to establish a framework for the future merger of Mercosur and NAFTA into an FTAA.

Although Mercosur has its share of internal problems that could slow its expansion, the process is well underway. Chile has become an associate of Mercosur, and Bolivia, Venezuela, Colombia, and Ecuador expect to join before the end of 1996. Mexico is negotiating an agreement with Mercosur while simultaneously blocking U.S. and Canadian efforts to launch early talks between NAFTA and Mercosur. The proposed enlargement of Mercosur and creation of a SAFTA appeals to many Latin American politicians, intellectuals, and business leaders who support higher levels of protectionism and the notion of a united Latin American front capable of maintaining its economic and political independence from U.S. pressure and interference. Latin American integration is one of the oldest dreams in the region, and it is closer to being achieved today than ever before. Meanwhile, as the free trade express in Latin America picks up speed, the U.S. lags behind even the caboose.

The new U.S. partnership with Latin America celebrated by President Clinton at the Summit of the Americas has developed serious cracks. For example, entities such as the Rio Group and the Organization of American States (OAS) have condemned the U.S. for enacting the Helms-Burton Act against Cuba and for decertifying Colombia in the war on drugs. U.S. policy against Cuba also has raised tensions significantly with NAFTA partners Mexico and Canada. Mexico has attacked recent changes in U.S. immigration policy. A pattern of mutual recrimination has emerged. The U.S. criticizes Latin America's coddling of Fidel Castro's regime and punishes countries like Colombia and Mexico for not doing enough to control drug trafficking and illegal immigration. Latin American governments criticize what they perceive as the return of U.S. "big stick" unilateralism and feel betrayed by Washington's bipartisan stampede away from NAFTA's expansion and the FTAA process.

Leading by Example. If the U.S. expects Latin America and the Caribbean to cooperate on policy issues viewed as important to U.S. economic and security interests, it must assert its leadership and set the example. Abandoning trade commitments like adding Chile to NAFTA is the antithesis of leadership, and it sets a bad example. Instead of building a bridge to the 21st century that would unite the U.S. and the democracies of the Western Hemisphere, the U.S. retreat from NAFTA's expansion and the U.S. government's managed trade policies have dug a moat between Washington and the rest of the Americas.

To restore American leadership to the FTAA process and repair the recent damage to U.S. relations with Latin America and the Caribbean, the U.S. Administration should carry out the following ten initiatives:

1. Approve a new fast-track negotiating authority.

Without fast-track in hand, the Administration cannot enter into serious trade negotiations with Chile or any other country. Chile has claimed that it will not negotiate its entry into NAFTA until fast-track is renewed. Suggestions that fast-track is not necessary to enter into trade negotiations are mistaken. No country will invest the time or the human and financial resources in negotiating with the U.S. if American negotiators cannot guarantee that any agreement reached will not be mutilated beyond recognition by the U.S. Congress.

Without fast-track, U.S. participation in and influence at the third post-Summit of the Americas Trade Ministerial during the second quarter of 1997 in the Brazilian city of Belo Horizonte will be marginal at best; moreover, U.S. proposals are more likely to be rejected. Symbolically, making renewal of fast-track one of the first actions of a new Administration and Congress would constitute a strong reaffirmation of America's commitment to free trade and would send Latin America a powerful message that the U.S. has re-engaged in the FTAA process. The dynamics of the Belo Horizonte trade ministerial could be altered completely if the U.S. delegation arrives with fast-track negotiating authority. Without fast-track, however, the U.S. risks being left behind again as Brazil's vision of turning Mercosur into a SAFTA stokes the enthusiasm of other Latin American governments.

2. Expand NAFTA during 1997 to include Chile.

One of the greatest mistakes made recently by the U.S. in Latin America was postponing the inclusion of Chile in NAFTA until after the 1996 elections. The failure to add Chile to NAFTA weakened American leadership and influence in the FTAA process.

There is no reason to delay the admission of Chile to NAFTA. Chile's total gross national product is equivalent to about 1 percent of the American economy. Chile has enjoyed positive economic growth for 14 consecutive years. Growth during the past six years under a democratic civilian government has averaged 7.5 percent annually. Chile has pre-paid a large chunk of its external public sector debt, has no balance-of-payments problems, and has enjoyed single-digit inflation since 1994. Its investment and savings rates are approaching those of the Asian Tigers. The inclusion of Chile in NAFTA would confirm America's commitment to leading the FTAA process, open a new gateway for U.S. exports to markets in South America and APEC, and provide America with valuable strategic leverage for future convergence talks with Mercosur.

3. Include the Caribbean Basin Initiative (CBI) countries in NAFTA.[19]

H.R. 553, stalled in Congress since 1995, is intended to correct an imbalance created by NAFTA that directly affects the interests of U.S. producers, importers, retailers, and consumers. The bill was developed to assure "parity" for producers in CBI countries with the market access provided to Mexican producers under the NAFTA. Such parity is badly needed. The Bush and Clinton Administrations mistakenly assumed that NAFTA would not divert trade and investment from the CBI countries. Since the implementation of NAFTA on January 1, 1994, U.S. imports of certain products (such as apparel) produced in the CBI countries by American firms have been affected adversely. The trade advantages created by NAFTA have enhanced the attractiveness of Mexico as a site for investing in manufacturing operations for export to the U.S. As a result, the rate of growth for apparel imports from CBI countries into the U.S. fell from 25 percent during 1995 to about 8 percent for the first five months of 1996, while apparel imports from Mexico during the same five-month period grew by 41 percent.[20]

4. Launch a dialogue to integrate NAFTA and Mercosur.

The dynamics of the FTAA process have changed. The U.S. has squandered a two-year window of opportunity to influence the timetable and pathway for creating an FTAA, and Mercosur has emerged as a viable alternative pathway to an FTAA that many Latin American countries find appealing. Therefore, NAFTA and Mercosur should engage quickly in a formal dialogue with the goal of deepening and harmonizing trade disciplines as both groups take on new members. The ultimate objective should be to merge the two regional blocs into one hemispheric FTAA by 2005.

Since 1995, the Clinton Administration has been trying without success to establish a formal dialogue between NAFTA and Mercosur. The problem is a series of disagreements among the U.S., Mexico, and Canada.[21] Mexico opposes a NAFTA-Mercosur dialogue, arguing that it is not needed to achieve an FTAA by 2005 and that NAFTA should focus instead on granting real negotiating powers to the 11 technical work groups involved in the FTAA process.[22]

Canada supports the U.S. proposal for a NAFTA-Mercosur dialogue but is reluctant to proceed without Mexico. The Canadians also oppose creating an FTAA as a path-

---

19 See note 3, *supra*.

20 Stephen Lande, "The Struggle to Provide Access for Caribbean Apparel into the United States Similar to That Provided to Mexico Under NAFTA," Manchester Trade Ltd., Washington, D.C., 1996.

21 "No NAFTA-Mercosur Talks Are Needed to Forge FTAA, Blanco Insists," *Inside NAFTA*, Vol. 3, No. 11 (May 29, 1996), p. 1.

22 U.S. and South American critics believe that Mexico opposes a NAFTA-Mercosur dialogue because it fears being displaced by Brazil as the chief mediator between the U.S. and Latin America in the FTAA process. Critics also say that Mexico wants to slow the expansion of NAFTA in order to preserve the special trading privileges it enjoys as the only Latin American member of the trade pact.

way to NAFTA-Mercosur convergence by 2005. Instead, the Canadians favor replacing NAFTA and Mercosur with a new agreement negotiated simultaneously by all 34 democracies in the Western Hemisphere. Further complicating matters, enactment of the Helms-Burton Act has divided NAFTA, as Mexico and Canada are bitterly opposed to its implementation. As a result, the U.S. and Brazil announced in late August that an overdue report on the status of their ongoing bilateral trade review would be delayed. Several rounds of technical talks failed to achieve any breakthroughs on bilateral issues, such as improving the implementation of anti-dumping and countervailing duty laws in both countries. In addition, the July 1996 deadline for holding the first formal meeting between NAFTA and Mercosur was missed.

5. Define a pathway and timetable for creating the FTAA.

The U.S. should urge Western Hemispheric nations to decide quickly whether the FTAA should include commitments that go beyond those already made in NAFTA and the WTO or should be abandoned in favor of merely removing tariffs on goods traded within the region.[23]

Defining the timetable and pathway for the FTAA would advance the regional trade process in three ways: 1) It would focus the efforts of the 11 FTAA working groups set up to prepare for future negotiations; 2) it would help establish priorities for the FTAA agenda; and 3) it would help set a better stage for the difficult negotiations of the details of an FTAA agreement. The U.S., Canada, Mexico, Chile, Colombia, and Costa Rica at various times have supported an FTAA based on WTO-plus disciplines in which, by 2005 when the FTAA is scheduled to go into effect, all of the commitments and trading disciplines established under the WTO would be implemented. However, Brazil has forcefully opposed proposals for an FTAA that goes beyond the WTO.

A fast-track negotiating authority in hand before the third post-Summit of the Americas trade ministerial next year in Brazil would improve the prospects for faster trade liberalization based on NAFTA/WTO-plus trading disciplines. Without fast-track, U.S. hopes of accelerating and enriching the FTAA process may be stillborn at the Belo Horizonte trade ministerial in 1997.

6. Implement reforms that do not require formal negotiations.

There are many unilateral actions that governments in the Western Hemisphere could take without engaging in formal state-to-state negotiations. Moreover, these reforms could yield swift benefits for both the U.S. and Latin America, since they would improve market access by injecting more transparency into the government rulemaking process and by dismantling tariff and non-tariff barriers to the faster and more efficient movement of goods, services, and capital throughout the region. For example, governments could simplify and harmonize rules and regulations relating to customs practices, sanitary standards, and technical barriers to trade. They also could pledge to avoid imposing new tariff and non-tariff barriers or raising existing barriers to the flow of goods, services, and investment within the region.

23 "Scope of FTAA Should Be Defined Rapidly, IDB Paper Says," *Inside NAFTA*, Vol. 3, No. 17 (August 21, 1996), p. 1.

A third area in which governments should move quickly is revision of national investment laws to guarantee the right of establishment and national treatment of foreign investors, no restrictions on repatriation of profits and capital and access to convertible currency for all such transactions, protection against expropriation and compensation at fair market value in the event expropriation occurs, and phaseout of all performance requirements. Yet another area in which swift reforms are possible is the enactment of laws and policies that provide world-class protection for patents, copyrights, trademarks, and trade secrets. Moreover, barriers to trade in services should be removed quickly, particularly in the areas of finance, telecommunications, and transportation. In addition, governments in Latin America should eliminate requirements and preferences in their purchase of goods and services, reduce market-distorting subsidies, and strengthen national competition laws.[24] These reforms would accelerate the momentum of the FTAA process and yield tangible benefits in the form of faster trade growth and increased foreign direct investment flows in the Western Hemisphere.

7. Establish separate negotiations on issues unrelated to free trade.

Both the expansion of NAFTA and U.S. leadership in the FTAA process have been undermined by the Clinton Administration's insistence on linking trade agreements to issues unrelated to free trade, such as labor standards and the environment. The Administration has threatened to impose trade sanctions against Colombia because President Ernesto Samper financed his 1994 election campaign in part with $6 million contributed by the Cali drug cartel. It also has delayed the implementation of a NAFTA obligation to allow Mexican trucks to circulate freely in the American Southwest, alleging concern about drug trafficking and U.S. national security.

However, while hemispheric negotiations may be required to find common solutions to problems such as drug trafficking, illegal immigration, the environment, and labor standards, such pressure tactics work against U.S. interests in the region. Trade sanctions generally are not effective. Moreover, Latin American governments are unwilling to accommodate the Clinton Administration's demands for labor and environmental linkages to trade agreements; as a result, they will likely seek alternatives to NAFTA, such as Mercosur, SAFTA, the European Union, and Asian countries like Japan and Korea.

8. Negotiate FTAs with New Zealand, Singapore, and Australia.

Many free traders believe that the pathways followed in creating the FTAA do not matter as long as a hemispheric free trade area is up and running by 2005. However, the recent breakup of the FTAA process into smaller regional trade agreements such as NAFTA and Mercosur is not a positive development. Smaller regional trade agreements may encourage increased trade and investment among the respective members of each group, but higher external tariff and non-tariff barriers to trade with countries that are not members of these groups hinder the efficient global movement of goods, services, and capital. The U.S. should refocus on multilateral trade liberalization and

24 Ambassador Julius L. Katz and Robert C. Fisher, "FTAA 2005: An Agenda for Progress," a study commissioned by the Council of the Americas, Chamber of Commerce of the U.S.A., and Association of American Chambers of Commerce in Latin America, March 1996.

use regional free trade areas such as NAFTA to spur even larger trade zones. Negotiating bilateral NAFTA/WTO-plus trade agreements with Australia, New Zealand, and Singapore could energize the FTAA process, spur faster progress in APEC, and create momentum for merging the FTAA and APEC into a single free trade area.

9. Convene a second Summit of the Americas in 1997.

A second Summit of the Americas should be convened in Chile in December 1997 to put the FTAA process back on a fast track to completion by 2005. However, before the second summit is held, the U.S. should renew fast-track, Chile should be included in NAFTA, and the CBI countries should be granted trading parity with NAFTA members. At this summit, the leaders of the hemisphere's democracies should agree on three things: 1) a specific pathway and timetable for achieving an FTAA; 2) creation of an institutional entity similar to the WTO to coordinate the FTAA negotiations; and 3) empowering the 11 technical working groups to negotiate firm FTAA proposals related to their respective areas of responsibility. In addition, APEC countries should be invited to participate as observers.

10. Dismantle domestic U.S. barriers to free trade.

The greatest impediments to free trade and creation of the FTAA are found in Washington. For decades, the federal government has operated a vast and complex protectionist machine that has cost American taxpayers and consumers hundreds of billions of dollars. This protectionism comes in many forms, including traditional tariffs, quotas, "voluntary" restraint agreements, orderly marketing agreements, antidumping duties, countervailing duties, tax regulations, technology controls, anti-trust laws, and many other anti-trade weapons used against foreign exporters seeking greater access to the U.S. market as well as American firms and investors trying to compete globally.

Instead of protecting American consumers, preserving jobs, strengthening American manufacturing, encouraging new technology development, and improving American competitiveness in the global economy, this protectionism weakens U.S. companies in the international marketplace, promotes investment in noncompetitive sectors, enshrines low-skilled workers, and hinders productivity growth. American consumers pay a high price for these misguided policies. For example, the Federal Reserve Bank has estimated that import-protection schemes amount to the equivalent of a 23 percent income tax surcharge for low-income American families, or 10 percent for the average family. The Federal Trade Commission has determined that it costs the U.S. economy nearly $90 for each dollar saved by protected American firms. Overall, congressionally mandated protection and managed trade policies cost American consumers at least $70 billion a year and encourage America's trading partners to retaliate in kind, especially in the areas of anti-dumping and countervailing duty legislation.[25]

Since 1993, the Clinton Administration has preached the gospel of free trade in international forums such as the WTO, APEC, and the FTAA. In practice, however, the Administration's "strategic trade policies" have laid the foundations for even greater U.S. government protectionism and interference in the economy. For example, the Admini-

25 Pattison, *Breaking Boundaries*, p. 55.

stration's National Export Strategy[26] and Big Emerging Markets (BEMs) Initiative[27] outline the twin pillars of an industrial policy and an expanded federal government role in the international marketplace. The basic premise of these strategies is that "U.S. firms will need the U.S. government at their side to win a fair hearing" in the global marketplace.[28] According to President Clinton, the BEMs Initiative "streamlines Administration resources to focus on the markets in which government involvement can truly make a difference for America's businesses and workers."[29]

Where trade policy is concerned, the Clinton Administration is making big government even bigger. The Administration has targeted domestic "clusters" of high-technology industries for export to key foreign markets where the U.S. government can help American firms secure market access, obtain financing, and win contracts for major projects in which foreign governments help competing bidders or play an important decisionmaking role in awarding projects.[30] In addition, the Administration has established new divisions at the International Trade Administration and the Office of the U.S. Trade Representative to monitor and enforce foreign compliance with U.S. trade laws and agreements.[31] The Administration also wants other trading nations to adopt a core set of labor principles as part of any future trade liberalization, and continues to insist that any new fast-track negotiating authority must contain strong negotiation provisions on both labor and the environment even though Latin American governments have strenuously opposed such linkages.

CONCLUSION

The U.S. has lost its once-respected leadership role in Latin America. The Clinton Administration turned its back on Latin America when the Mexican peso tumbled in December 1994. The expansion of NAFTA has stalled, and the U.S. no longer leads the FTAA process. Although Latin America has recovered from the aftershocks of the peso crisis and trade expansion continues unabated throughout the Western Hemisphere, the Clinton Administration and many in Congress are reluctant to put the expansion of NAFTA back on a fast track. Instead, they are behaving as though the American economy ends at the Atlantic and Pacific continental shelves, with nothing beyond the continent but an economic void that threatens America.

From 1980-1992, the Reagan and Bush Administrations forged the closest friendship with Latin America that the U.S. has ever enjoyed. However, it took the Clinton Administration less than three years to dissolve that exciting new relationship in acrimonious recriminations and unkept American promises. If the Administration does not halt its flight

26 Ronald H. Brown, "Competing to Win in a Global Economy," U.S. Department of Commerce, September 1994.

27 International Trade Administration, *The Big Emerging Markets: 1996 Outlook and Sourcebook*, U.S. Department of Commerce, 1996.

28 *Ibid.*, p. 18.

29 *Ibid.*, p. 8.

30 *Ibid.*, p. 24.

31 "Commerce to Scrap or Rewrite Half of Regulations This Year," *International Trade Reporter*, Vol. 13, No. 20 (May 15, 1996), pp. 794-795.

from free trade and the expansion of NAFTA, U.S. economic and security interests in the Americas could suffer a sustained decline.

John P. Sweeney
Policy Analyst