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*The Free Trade Area of the Americas:
How Deep an Integration in the Western Hemisphere?*

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1. Introduction

Economic integration in the Western Hemisphere grows out of distinct historical visions in North and South America. The concept of a North American economic market dates from the 19th century. In its early manifestations, economic union was closely – in fact too closely – associated with political union. Thanks in part to loose rhetoric, particularly the colorful remarks of House Speaker Cannon, Canadians came to see economic union as a device for turning Canadian provinces into American states. Thus, on four occasions between the mid-nineteenth century and the end of the Second World War, Canada rejected overtures for something like a free trade area. Meanwhile, resentful of American territorial acquisitions and military intervention, Mexico did its utmost to limit commerce with the United States.

The story in Latin America ran a different course with the same result. The charismatic Simon Bolivar (1783-1830) deployed his considerable military skills to liberate the Andean countries and create a single state north of Brazil. Bolivar's autocratic ways, however, sparked local revolts, followed by periodic border disputes over the next century. These were accompanied by episodic battles both within in the southern cone and within Central America. Partly owing to decades of strife, at the end of the Second World War, Latin American countries conducted the great bulk of their trade and finance with the United States and the United Kingdom, and very little commerce with one another. The subsequent era of import substitution (roughly 1950 to 1970) reinforced the commercial isolation of Latin American states from one another. The Latin American "common markets" of the 1960s and 1970s were essentially paper agreements, with little economic content.

From Import Substitution to Economic Integration

Thinking changed in the late 1980s and 1990s. A decade of sub-par performance, with high inflation and financial crises, propelled Latin American political and business leaders to search for new models. They embraced three pillars of what was later dubbed the "Washington consensus": fiscal rectitude, sound money, and freer trade. Political leaders were not suddenly convinced by the logic of Paul Samuelson, Milton Friedman or David Ricardo; but they were persuaded by the sparkling performance of East Asia. Canada and Mexico experienced parallel, if less dramatic, conversions.

Political strategy played a role. Leaders in Ottawa and Mexico City found that declarations of economic independence from the United States had less popular payoff. Leaders in Santiago, Buenos Aires, Brasilia and other capitals found that nationalistic agendas -- rectifying old wrongs, redrawing old borders -- were no longer central to popular concerns. But the driving force behind the new agenda was the hope of economic prosperity, not the hope of averting military hostility. In this critical respect, free trade agreements in the Western Hemisphere flowed from a different logic than free trade agreements on the European Continent and in Southeast Asia.

Intellectual Firepower

Three sets of empirical findings, distilled from the research of economists, underpinned the hemispheric free trade agenda. The first was the connection, stressed by Bela Balassa (1965), between rising intensity of trade (exports plus imports as a percent of GDP) and rising levels of per capita income. Interpreting the connection as causation -- a matter of continuing debate -- the GDP gains resulting from trade liberalization far exceed the gains that might be calculated from textbook static equilibrium analysis. This was a dramatic finding. It spawned a literature of dynamic trade models which eventually persuaded policy officials that trade expansion *causes* per capita income to rise, and is not merely a *consequence* of higher GDP.

The second set of findings underpinning the liberalization agenda, and indeed transforming it into a free trade *and investment* agenda, originated with the research of Raymond Vernon (1966) and John Dunning (1966). They discovered a strong connection between foreign direct investment (FDI) sponsored by multinational enterprises (MNEs), and dense international networks of trade in goods and services. "Slicing the value added chain" and "outsourcing" later became sound bite descriptions. The concept of autonomous enterprises dealing at arm's length with one another describes much of world trade. But commerce between related MNE entities accounts for an enormous volume of trade in manufactured goods and business services. Countries that provide hospitable conditions for MNEs find it that much easier to break into export markets. As a happy coincidence, free trade and investment complement one another: liberal trade policies turn out to lure more MNEs than protected home markets, especially for small and medium sized countries. Ireland and Singapore are two nations that applied the teachings of Vernon and Dunning with great success.

The third set of findings underpinning the free trade and investment agenda was the economic convergence literature, pioneered by Robert Barro and Xavier Sali-I-Martin (1992). These and other scholars detected a catch-up by poorer states in the United States and poorer regions in post-war Europe, closing the initial gap as fast as 2 percent per year over long periods. Internal free trade and investment are hallmarks of an economic union. As John McCallum (1995) and Robert Helliwell (1998) discovered, trade intensities within Canada and the United States are many times denser (by factors between five and twenty) than trade intensities across borders, after allowing for distance, province/state economic size, and other control variables. The obvious inference, so it seemed, was that freer trade and investment policies within the hemisphere would not only stimulate commerce, they would also enable poorer countries to catch up with their richer partners.

These three sets of empirical findings furnished the intellectual firepower for a new wave of trade agreements. Without the new findings, it would have been harder for liberal-minded leaders to overcome vested interests. As it happened, by the early 1990s, free trade and investment policies came to be widely recognized as desirable reforms from the laboratory of economic growth.

Disappointing Decade

Now, after a decade of reform policies and trade agreements, disappointment is setting in. Table 1 gives the performance numbers. We can leave the United States out of the story, since freer trade and investment only played a supporting role in the boom of the 1990s. Elsewhere in the hemisphere, Chile, Costa Rica, El Salvador, the Dominican Republic and six small Caribbean countries enjoyed per capita GDP growth of more than 25 percent over the decade. Argentina did well through until 2001, and then disaster struck. Most of the hemisphere had a mediocre decade, not as bad as the 1980s, but less than the promise of the early 1990s. Venezuela, four smaller countries, and Argentina (as of 2002) suffered negative per capita income growth for the decade as a whole.

Examined through the lens of economic convergence (see Table 1), 11 Latin American countries (including Argentina as of 2001) with combined population of 74 million converged towards the US per capita GDP during the course of the 1990s (the population figure drops to 37 million if Argentina is excluded). By contrast 13 countries (not including Argentina) with a combined population of 313 million diverged from the US per capita GDP. Eight countries, with combined population of 153 million, neither converged nor diverged. This is the context of the FTAA negotiations that were formally launched at the Miami Summit of the Americas in 1994: great expectations, disappointing performance, but still hope.

2. *Trade Agreements in the Western Hemisphere*

In the middle 1990s, bilateral and regional FTAs surpassed the multilateral GATT/WTO system as the lead engine of trade policy. Bhagwati and Panagariya (1996) bemoan the encroachment of FTAs; Bergsten (1996) celebrates their contribution to “competitive liberalization”.² Whatever the relative merits of bilateral and regional agreements, they are a fact of commercial life: Schott (2003) has counted a grand total of 283 FTAs, including those notified to the WTO (153), those concluded but not notified (83), and those under negotiation (45).

The Western Hemisphere is a leader in the worldwide rush to preferential trade arrangements: 60 full and partial-scope agreements now exist between Western Hemisphere nations.³ The Canada-US Free Trade Agreement (CUSFTA), ratified in 1989, provided the template for the North American Free Trade Agreement (NAFTA), which came into force in January 1994. NAFTA in the north, together with MERCOSUR in the south (ratified in 1991), provided inspiration for launching the hemispheric-wide Free Trade Agreement of the Americas (FTAA) in December 1994. Numerous other regional agreements have either been negotiated or re-invigorated over the past decade.

² As Hufbauer put the matter in 1989, before the term “competitive liberalization” was coined: “In fact, even the remote possibility of trade diversion is part of the magnetic allure of a vital free trade area. The prospect of trade diversion prompts other countries to seek affiliation with the group, and the end result is to enlarge the zone of liberalization.” (Hufbauer, 1989, p. 136).

³ Figures for full and partial-scope FTAs in the Western Hemisphere come from OAS (2003). In addition, some nations have multiple agreements with partners outside the Hemisphere. After the EU and EFTA (which together have 71 FTAs in all stages), Mexico leads the world with 15 FTAs; Chile comes third with 13.

Table 1. Western Hemisphere Income per Capita by (constant 1995 \$US), 1990 and 2000/01

Country	GDP per capita (constant 1995 \$US) 1990	Ratio to US 1990	Population (thousands) 2000	GDP per capita (constant 1995 \$US) 2000-01	Ratio to US 2000-01	GDP per capita increase (%) 1990 to 2000	GDP per capita (PPP) 1990	GDP per capita (PPP) 2000-2001
Antigua and Barbuda	6,980	0.27	68	9,062	0.29	30%	26,141	31,592
Argentina	5,776	0.22	37,488	7,913	0.25	37%		United States
Bahamas	13,836	0.53	310	13,836	0.44	0%		
Barbados	7,330	0.28	268	8,522	0.27	16%		
Belize	2,543	0.10	247	3,125	0.10	23%		
Bolivia	836	0.03	8,515	954	0.03	14%		
Brazil	4,079	0.16	172,386	4,626	0.15	13%		
Chile	3,283	0.13	15,402	5,304	0.17	62%		
Colombia	2,119	0.08	43,035	2,285	0.07	8%		
Costa Rica	2,945	0.11	3,873	3,928	0.12	33%		
Dominica	2,871	0.11	72	3,432	0.11	20%		
Dominican Republic	1,377	0.05	8,505	2,054	0.07	49%		
Ecuador	1,475	0.06	12,879	1,425	0.05	-3%		
El Salvador	1,376	0.05	6,400	1,759	0.06	28%		
Grenada	2,822	0.11	100	3,809	0.12	35%		
Guatemala	1,358	0.05	11,683	1,562	0.05	15%		
Guyana	604	0.02	766	934	0.03	55%		
Haiti	482	0.02	8,132	368	0.01	-24%		
Honduras	683	0.03	6,585	711	0.02	4%		
Jamaica	2,235	0.09	2,590	2,149	0.07	-4%		
Mexico	3,187	0.12	99,420	3,806	0.12	19%		
Nicaragua ^a	446	0.02	5,205	437	0.01	-2%		
Panama	2,523	0.10	2,897	3,243	0.10	29%		
Paraguay	1,822	0.07	5,390	1,703	0.05	-7%		
Peru	1,905	0.07	26,347	2,311	0.07	21%		
St. Kitts and Nevis	4,555	0.17	45	6,535	0.21	43%		
St. Lucia	3,542	0.14	157	3,771	0.12	6%		
St. Vincent and the Grenadines	2,168	0.08	116	2,737	0.09	26%		
Trinidad and Tobago	4,094	0.16	1,310	5,553	0.18	36%		
Uruguay	4,870	0.19	3,361	5,870	0.19	21%		
Venezuela, RB	3,350	0.13	24,632	3,326	0.11	-1%		

No fewer than 15 full-scope free trade agreements (FTAs) have been signed (and most of them ratified and in force) as of end 2003. Following the NAFTA precedent towards more far-reaching rules and greater market access, most of these agreements cover a wide and ambitious number of trade issues, as shown in Table 2, ranging from tariffs and non-tariff barriers, to standards and technical regulations, investment, services, government procurement and competition policy. The services area, in particular, is treated in considerable depth in many of these FTAs through the inclusion of separate chapters with specific disciplines on cross-border trade in services, financial services, air transportation, telecommunications, and the temporary entry for business persons (although not all agreements include chapters on all of these sectors/modes of supply).

The two most recent FTAs (Chile-United States and CAFTA, which links Central America with the United States) also innovate through the inclusion of new chapters with disciplines on electronic commerce and transparency, as well as chapters on trade-related labor and environmental issues that fall within the body of the agreement. All the 15 FTAs (minus one) include a binding state-to-state dispute settlement mechanism. Additionally, several of the NAFTA-inspired agreements provide for an investor-state dispute settlement mechanism in the event differences arise under the investment chapter.

Of the four regional agreements in the Western Hemisphere that are customs unions (Andean Community, Central American Common Market, CARICOM and MERCOSUR, shown in Table 3), the first three predate the NAFTA by several decades. They have however been reinvigorated by their members in the mid-1990s and revamped to become modern, comprehensive trade agreements, adding protocols or decisions covering many new areas embraced in the Uruguay Round and the NAFTA (such as services, investment, competition policy and intellectual property). However, many of the protocols negotiated by MERCOSUR have not yet been implemented, while the process of implementing the various decisions and resolutions adopted by the Central American and the Andean Community countries is moving very slowly, since these commitments are ambitious. All of the customs unions have also added on a binding dispute settlement mechanism.

Thus experimentation with regionalism in the Western Hemisphere has been highly dynamic. All of the thirty-four countries of the Hemisphere participate in one or more of the 19 current reciprocal regional agreements, and a few countries – especially Mexico and Chile – are members of several. The agreements negotiated range from moderately to very ambitious and have pushed the envelope of regionalism forward in the Americas more than in other continents outside Europe.

3. *The FTAA Aspiration*

While the NAFTA agreement covers the majority of trade that takes place within the Western Hemisphere, the Free Trade Area of the Americas (FTAA) has larger economic dimensions either than existing sub-regional agreements or individual bilateral FTAs now under

consideration in Washington.⁴ It is also placed in the context of a broad social and political agenda that is absent in the case of other free trade agreements.

President George H.W. Bush launched the concept of hemispheric free trade in 1990, under the label Enterprise for the Americas Initiative (EAI). This concept was not new in the Americas, having been first proposed by Simon Bolivar, the liberator of the countries of the Andean region, more than 200 years earlier. The EAI was sidetracked during the NAFTA ratification battle, but was revived and rechristened as the FTAA by President Bill Clinton at the first Summit of the Americas, when 34 democratically-elected governments in the Western Hemisphere met in Miami in December 1994.⁵

Thus the FTAA process began as an integral component of the Summit of the Americas, endorsed by heads of state and government in the Americas. The FTAA component of the “Partnership for the Development and Prosperity of the Americas” of the Summit of the Americas process is nestled in a commitment to four major objectives and 23 very wide-ranging economic, political and social initiatives (Salazar-Xirinachs and Roberts, 2001, p. 281). The four major objectives are to preserve and strengthen democracy, to promote prosperity through economic integration, to eradicate poverty and discrimination, and to guarantee sustainable development. Although the Summit initiatives range from the promotion of democracy and human rights to sustainable development, improved infrastructure and labor conditions, educational opportunities, control of narco-trafficking, among others, the FTAA is generally viewed as the centerpiece of the Summit process, through its potential contribution to increased economic prosperity in the region.

Unique characteristics of the FTAA

The FTAA process has been ongoing now for nine years, a long time even compared to the pace of multilateral trade negotiations. However, considerable preparatory work was figured into the timeframe, partly in order to train negotiators from countries of widely diverging levels of capacity and negotiating readiness, a strategy that has proven successful. During the first three preparatory years, background documents and initial discussions were undertaken in various working groups. The FTAA negotiations were formally launched at the Trade Ministerial Meeting in Costa Rica in March 1998 and endorsed by the Heads of State and Government at the Second Summit of the Americas in Santiago de Chile in April 1998. Since that time there have been four meetings of Trade Ministers of the hemisphere (Toronto, Buenos Aires, Quito and Miami) and 17 meetings of Vice Ministers of Trade. The end date for the negotiations was fixed at the outset as January 2005, making the FTAA a decade-long project.

The FTAA negotiations are notable for several reasons.

⁴ In 2003, the United States concluded FTAs with Singapore and Chile, which have slightly more economic importance than the previous US FTAs with Israel and Jordan. The United States initialed an FTA with Australia early in 2004, but Australia only constitutes 1.1 percent of US trade and 2.5 percent of the US FDI stock. Leaving aside Canada and Mexico, only six percent of US trade with the world in 2002 involved other potential FTAA partners. The United States has more investment in the rest of Latin America than in Mexico, but less than in Canada.

⁵ For background, see Hufbauer and Schott (1994) and Schott (2001).

1. Size of the potential free trade area to be created. The countries negotiating the FTAA stretch from the Alaskan Yucatan in North American to Tierra del Fuego in South America. The future FTAA will be larger than any other regional trading agreement in the world except for the European Union (a customs union and not a free trade area). The 34 countries involved represent a combined population of over 800 million people, a GDP of \$13 trillion and trade flows of \$3.4 trillion, thus constituting approximately one-fourth of the world's output and one-fifth of the world's trade.
2. Ambition of the negotiating mandate. The scope of the negotiations is very broad, encompassing subjects that are not yet on the negotiating table at the WTO but that have been discussed in the FTAA since the beginning of the process. The nine negotiating areas include not only the traditional market access questions on tariffs and non-tariff barriers for goods (including of course agriculture), but also services, investment, government procurement, as well as intellectual property rights, anti-dumping, subsidies and countervailing duties, competition policy, and dispute settlement where rules are being developed for the hemisphere. Three non-negotiating groups deal with institutional issues, civil society and the unique situation of smaller economies to round out the FTAA process. Some 900 negotiators from around the hemisphere have been meeting on a bi-monthly cycle for more than five years to discuss these issues.
3. Incorporation of countries of very differing levels of size and economic development and thus a particular attention to the needs of smaller economies and to capacity-building as part of the FTAA process. The FTAA negotiations are unique in having established for the first time a Consultative Group on Smaller Economies, which was subsequently been reproduced at the WTO level in the Doha Declaration. FTAA Ministers have also agreed to establish a Hemispheric Cooperation Program to attend to the technical assistance and capacity needs of smaller countries, both during the negotiations and after they are completed..
4. Transparency of the FTAA negotiating process. Lastly, the FTAA has been unique in creating a Committee on Civil Society from the outset of the negotiations. Public submissions are welcomed on an ongoing basis and open meetings are held periodically on the various negotiating issues.. Recently in Miami a Sustainable Development Forum took place to debate broader civil society concerns and to transmit these to Ministers. Additionally and very significantly, the draft text of the FTAA Agreement has been made public on three different occasions. This represents a unique step in the history of trade negotiations and the first time that governments involved in a negotiating process have published the draft negotiating text. The draft text of the FTAA Agreement in its entirety, as it has been negotiated to date (through end 2003), can be found on the official FTAA website at www.ftaa-alca.org

These four characteristics that distinguish the FTAA process - size, ambition, diversity, transparency - set it apart from other regional negotiating efforts and agreements. However, these unique characteristics have also created major challenges to the FTAA. Six years into the negotiating process, doubts have been raised from several quarters as to the feasibility of the original FTAA vision. At the Trade Ministerial meeting held in Miami on

November 20th 2004, several questions were being raised by participating governments, including:

- i) Scope: Is the scope of the FTAA still suitable for all participants?
- ii) Ambition: Does the ambition of the proposed agreement go too far?
- iii) End date: Is the 2005 end date set for the FTAA a realistic one?
- iv) Redefinition: In light of various political constraints, how can the negotiations be redefined to make them acceptable to all and meet the stated deadline?

We take up these questions later on in our paper, in section 4 entitled “*The FTAA a Decade Later – a New Context.*”

What Kind of Benefits?

The FTAA project has burned brightly up to now in the minds of negotiators because of the potential benefits the future agreement will bring to promote the economic development objectives of Latin American and Caribbean countries. As with NAFTA in the late 1980s and early 1990s, much of the enthusiasm for the FTAA project derives from the economic literature. Since that time models of multilateral liberalization and free trade agreements have advanced considerably. The models can be grouped into three categories:

- Computable general equilibrium (CGE) models based on the GTAP framework (Global Trade Analysis Project), which uses comparative statics;
- CGE models with dynamic features, such as induced competition, greater efficiency, scale economies, and more investment;
- Gravity models that use regression techniques to search thousands of cross-country merchandise trade flows for empirical regularities.

Dynamic CGE models tend to generate much larger estimates of trade creation than do static CGE models. There is less agreement within the modeling community, however, about the specification and ingredients of dynamic models. Gravity models – essentially single-equation regression models that explain bilateral trade volumes in terms of distance, GDP, and numerous other variables -- often generate surprisingly large parameters for the trade-enhancing effect of common membership in a free trade agreement.

Analysis done by DeRosa and Gilbert (2003) for a conference sponsored by the Institute for International Economics used both the static GTAP framework and the gravity model to size up the potential trade effects of various free trade arrangements. For reasons of data availability, they focused on merchandise trade. The FTAA was not analyzed *per se*, but DeRosa and Gilbert did analyze FTAs between the United States, Brazil, Chile, Central America, and several other countries, taken individually and in combination.

The static GTAP framework suggests that an FTA between the United States and Brazil would increase US merchandise exports to Brazil by 78 percent, and US merchandise imports from Brazil by 37 percent. From the US standpoint, these magnitudes are a little less than 1 percent of total US merchandise trade. From the Brazilian standpoint, the trade gains are between 8 and 9 percent of total Brazilian merchandise trade.

Using a similar framework, Diao, Diaz-Bonilla and Robinson (2002) calculated that an FTAA would increase US exports by 1.2 percent, Brazilian exports by 7.3 percent, and total FTAA trade by 1.9 percent. In dollar terms, total FTAA trade for all members (merchandise exports plus imports) would increase by \$59 billion. To summarize, different research groups working from the same GTAP model, obtain similar results: big percentage increases in bilateral trade flows, but modest or small percentage increases in overall trade flows.

The gravity model suggests a far more robust expansion of trade. The core parameter is that an FTA increases bilateral trade between the partners by 118 percent – a much bigger figure than static GTAP estimates. Based on this parameter, a Brazil/US FTA alone would expand Brazilian exports by 28 percent of Brazil's exports to the world. An FTA between the United States, Brazil, Chile, and Central America would expand exports from the Latin American partners by 41 percent of their world exports. Applying this figure to the whole region suggests total Latin American export gains of \$143 billion. In other words, depending on the model, the potential trade expansion for Latin America from an FTAA is someplace between modest and stunning.

The FDI estimates for an FTAA, again based on a gravity model, are equally striking for several Latin American countries (Yeyati, *et al*, 2002). FDI stock from Canada and the United States into MERCOSUR countries (mainly Brazil and Argentina) might increase by nearly 60 percent, and FDI from the rest of the world might increase by 26 percent. For Colombia and Venezuela, the respective gains are calculated at 80 percent and 44 percent. For two small countries, Costa Rica and Panama, the FDI stock gains are 130 percent and 80 percent, respectively.

The highest trade and investment calculations cited in this section probably exaggerate what a future FTAA could deliver. Nevertheless, these figures help explain the enduring enthusiasm for the FTAA, in the wake of a disappointing economic decade for Latin America.

FTAA Negotiating Objectives

The general objective for the FTAA negotiations as set out in the San Jose Ministerial Declaration (March 1998) is an ambitious one, describing the outcome of the negotiations in the following manner: “*To establish a Free Trade Area, in which barriers to trade in goods and services and investment will be progressively eliminated, concluding negotiations no later than 2005*”. Additionally, the San Jose Declaration sets out the basic principles for the negotiations that have been retained to the present. These are:

...the FTAA agreement will be balanced, comprehensive, WTO-consistent, and will constitute a single undertaking. It will take into account the needs, economic conditions and opportunities of the smaller economies. The negotiations will be transparent and built on consensus decision making. The FTAA can co-exist with bilateral and sub-regional agreements, to the extent that the rights and obligations under these agreements are not covered or go beyond the rights and obligations of the FTAA.

The FTAA Ministerial Declarations since that time (Toronto, November 1999; Buenos Aires, April 2001; Quito, November 2002; and Miami, November 2003) have re-emphasized the concepts of balance, comprehensiveness, WTO consistency and a single undertaking, though

with the important addition of the concept of “flexibility” in the Miami Ministerial Declaration that was not present in any of the previous ones.⁶

The FTAA negotiations have moved forward through negotiating proposals offered by the participants. Many of these mirror the text and existing disciplines of existing sub-regional agreements in the hemisphere (NAFTA and others), while others incorporate elements of newer agreements such as the ones between Chile and Central America (2002), Panama and Central America (2003), Chile and the United States (2004), and Central America and the United States (signed at end 2003, not yet ratified).

The benchmark for the FTAA negotiations are the WTO disciplines; however all parties recognize that it is necessary to go further in order to reach a “WTO-plus” agreement. The difficulty lies in wide-ranging judgments of what should be the acceptable level of “WTO-plus” disciplines. This is complicated by the fact that the WTO itself (or rather its members) has been unable to set out clear benchmarks for evaluating the compliance of regional trading agreements with WTO requirements – Article XXIV of the GATT in the case of goods and Article V of the GATS in the case of services. This lack of clarity has meant that FTAA members have considerable latitude to argue which disciplines and market access conditions qualify for “WTO-plus” status.⁷ Partly for this reason the regional agreements vary in their coverage and disciplines, as well as in their degree of market opening in goods and services. Such variety, together with the lack of clarity of WTO requirements, means that no single template exists for a hemispheric agreement.

As previously stated, the text of the third draft version of the entire FTAA agreement can be found on the official FTAA website, and various negotiating proposals can therefore be publicly verified. Some of the most important negotiating areas and the difficulties that each one presents in the FTAA are reviewed in the following sections.⁸

⁶ Toronto Ministerial Declaration (November 1999) : “We reaffirm the principles and objectives that have guided our work since Miami, including *inter alia* that the agreement will be balanced, comprehensive, WTO-consistent, and will constitute a single undertaking.”

Buenos Aires Ministerial Declaration (April 2001) : “...achievement of a balanced, comprehensive agreement that is consistent with the rules and disciplines of the World Trade Organization. We reaffirm that the result of the FTAA negotiations shall constitute a comprehensive single undertaking...” In the Quito Ministerial Declaration (November 2002) : “We reaffirm the basic principle of consensus in decision making within the FTAA process and the achievement of a balanced and comprehensive agreement that is also consistent with the rules and disciplines of the World Trade Organization (WTO). We reaffirm that the result of the FTAA negotiations shall constitute a comprehensive single undertaking that incorporates the rights and obligations that are mutually agreed for all member countries.” In the Miami Ministerial Declaration (November 2003) : “Ministers reaffirm their commitment to a comprehensive and balanced FTAA...and “Ministers also recognize the need for flexibility to take into account the needs and sensitivities of all FTAA partners.” These Ministerial Declarations can be found on the official FTAA web site at www.ftaa-alca.org

⁷ See article by Sherry Stephenson discussing GATS Article V, “GATS and Regional Integration: in *GATS2000: New Directions in Services Trade Liberalization*, edited by Pierre Sauve and Robert Stern (2000), Brookings Institution Press, pages 509-530.

⁸ The Organization of American States Trade Unit (OAS) and the Inter-American Development Bank (IDB), as two of the three members of the Tripartite Committee (the third member being the UN Commission for Latin America and the Caribbean, or ECLAC) maintain and update the official website for the FTAA process, located at www.ftaa-

Market Access. The elimination of tariff and non-tariff barriers to trade in goods (including agricultural products which are dealt with separately below) is the heart of any free trade area negotiation. One of the main objectives of the FTAA, as set out in the San Jose Ministerial Declaration of March 1998 that officially launched the negotiations, is to achieve this liberalization, namely:

- a) *To progressively eliminate, tariffs, and non tariff barriers, as well as other measures with equivalent effects, which restrict trade between participating countries.*
- b) *All tariffs will be subject to negotiation.*
- c) *Different trade liberalization timetables may be negotiated.*

Although the stated goal of the FTAA is to eliminate all barriers affecting trade in goods to reach a zero-tariff across-the-board, in reality many of the existing FTAs have not been able to eliminate all tariffs and notable barriers have been retained for agricultural products. Sensitivity over agriculture is most marked in Canada and the United States, while Latin American countries want to take advantage of their status as lower-cost agricultural exporters for numerous products that now face high barriers (tariffs, tariff-rate quotas, SPS requirements, etc.) in northern markets. Whether or not the FTAA will result in tariff elimination and/ or significant tariff reduction for all products or only for “substantially all trade” (as required by GATT Article XXIV for goods), is a question that negotiators must define. The outcome will most likely depend upon the balance of commitments and access that is undertaken across the board. Additionally, the negotiating group on market access in the FTAA covers four other important areas as well, including rules of origin, safeguards, customs procedures and technical barriers to trade.

Agriculture. In the FTAA, Latin American nations want to go further than the concept of “free trade” under the NAFTA and to discipline both export subsidies and domestic subsidies, as well as eliminate market access barriers.⁹ They argue, correctly enough, that US and Canadian subsidy policies severely distort the market and limit their export opportunities (Nogues, 2003b). In the San Jose Ministerial Declaration several objectives are set out for agriculture, including:

- a) *To progressively eliminate tariffs, and non-tariff barriers, as well as other measures with equivalent effects, which restrict trade between participating countries,*
- b) *To eliminate agricultural export subsidies affecting trade in the Hemisphere.*
- c) *To identify other trade-distorting practices for agricultural products, including those that have an effect equivalent to agriculture export subsidies, and bring them under greater discipline.*

alca.org . Additionally, the OAS maintains a very comprehensive set of official documents and trade agreements, together with useful summaries and analysis, on its website at www.sice.oas.org . In the academic literature, valuable papers have been authored by Nogues (2003b) and Benke and Rivas-Campo (2003), among others.

⁹ In NAFTA the agricultural area was treated differently than that of other goods, and is governed by bilateral agreements between the three parties rather than by a common agreement. As between Mexico and the United States, the NAFTA promises “free” agricultural trade, defined as the absence of no tariffs or quotas, after long delays and phase-ins for “sensitive” products like sugar, corn, beans, and several minor crops. There is no mention of export subsidies or domestic subsidies, nor are they disciplined.

This ambitious agenda has proved to be the Achilles heel of the FTAA and has made the agricultural negotiations extremely difficult. In turn, that has slowed the progress in other negotiating areas. From the start, the United States and Canada have insisted that domestic agricultural subsidies can only be negotiated at the multilateral level, in the WTO Doha Round. Neither country wishes to curtail its subsidy programs unless the European Union accepts similar disciplines. Even if Europe did an unlikely about-face on subsidy policy, important US agricultural interests will still try to retain their government checks after the Farm Act of 2002 expires in 2007. Moreover, several US agricultural lobbies have insisted that trade barriers (tariffs and tariff quotas) on sensitive US crops – some of great interest to Latin America – must be phased-out very slowly.

While all FTAA participants have agreed on several occasions (including at the Ministerial level), that one FTAA goal is to eliminate export subsidies on agricultural products traded within the hemisphere, the United States and others are worried about the ability of subsidized products from third countries outside the hemisphere (particularly the European Union and Japan) to undercut this discipline. They want to see a mechanism created both to deter and counteract imports of subsidized agricultural products from non-FTAA countries. Meanwhile Latin Americans are worried about the effects of continued domestic support if this is not going to be discussed within the FTAA, and would like a mechanism to neutralize the effects of such distorting measures and practices. For their part, the Caribbean countries wish to continue to enjoy the historical preferences they have with the European Union, as ACP (Africa, Caribbean and Pacific) former colonies. Priorities in agriculture thus remain far apart and controversial, though a meeting of the minds will be essential for the FTAA negotiations to move forward.

Services. Contrary to the area of trade in goods, the objectives for services in the FTAA negotiations do not envisage complete liberalization. Rather, the San Jose Declaration reads as follows for services:

Establish disciplines to progressively liberalize trade in services, so as to permit the achievement of a hemispheric free trade area under conditions of certainty and transparency.

Though business services and certain network services such as finance and telecommunications have been largely liberalized within North America and some Latin American countries, significant barriers to service suppliers still remain in some markets, whether this be in the form of restrictions on cross-border trade or on commercial presence (investment). However, even within North America there are still important sectors that continue to be reserved by each NAFTA party.¹⁰

The services area, along with investment (a mode of services supply enumerated in the WTO General Agreement on Services framework) has proven to be politically sensitive. Many Latin

¹⁰ For example, the United States has refused to move on maritime transport, Canada still protects its cultural industries, and Mexico maintains its nationalized energy sector, including electricity and drilling services. All three cases are outside of the disciplines of the agreement. And all three countries continue to limit foreign ownership of TV and radio. Indeed, most of the liberalization in the services area that has taken place in North America has occurred independently of the NAFTA, through voluntary liberalization rather than through negotiated market opening (the telecom sector is an excellent example of this). The main exception to this rule is the financial services sector in Mexico.

American nations fear that they will give up their right to regulate in a discriminatory fashion if they enter into services disciplines that comprehensively affect all sectors (particularly under the “negative list” approach). From the outset, Brazil and its MERCOSUR colleagues have linked progress in the services negotiations to progress in agriculture, and thus services talks have moved very slowly.

The services area is also beset with a major difference in vision as to how a trade agreement should be constructed. A large sub-set of countries (the “like-minded” NAFTA countries that have either negotiated with the United States or are in the process of doing so) wish to proceed along the lines of a negative list approach: comprehensive sector coverage and binding of all outstanding non-conforming measures at the level of current regulatory practice. However, other countries wish to proceed along the lines of the WTO GATS “positive list” approach, with sectors included at choice, and no or weak disciplines on the level of binding commitments.

The services area has been made hostage to the divisions and disappointments elsewhere in the FTAA negotiations. It is unclear what degree of liberalization Latin America (particularly MERCOSUR) would be willing to concede, were there significant market access breakthrough in agriculture and in anti-dumping rules. From an economic point of view, services are at the heart of the economic equation, to a much greater degree than agriculture or antidumping, but negotiators are understandably compelled to concentrate on old barriers rather than new opportunities..

Even if the modality for services liberalization is agreed (negative list or positive list), there will still be one area in which concessions will be extremely difficult for the United States. This is the question of the movement of natural persons seeking work abroad on a temporary basis (GATS mode 4), especially persons seeking work in the United States. Latin American and Caribbean countries want FTAA visas, akin to H-1B visas, not only for skilled workers and corporate employees, but also for an additional category of technical workers. For the United States it will be difficult to agree to numerical temporary work permits, given Congressional objections to mode 4 negotiations and heightened security worries.

Investment. The San Jose negotiating objective states investment goals, rather blandly:

To establish a fair and transparent legal framework to promote investment through the creation of a stable and predictable environment that protects the investor, his investment and related flows, without creating obstacles to investments from outside the hemisphere.

When this language was included in the negotiating agenda of the FTAA, investment was much less controversial than it has since become. One problem is the thorny question of where to place mode 3, or investment to supply services, and this decision is intimately linked to the type and extent of disciplines that will ultimately be agreed in the investment chapter. Another problem is how to define “investment” itself – in a broad, all-encompassing manner (including non-tangible assets such as stocks and bonds) or in a narrow sense, limited to foreign direct investment only. The most difficult problem however is the question whether investor-state disputes will be subject to arbitration, akin to the controversial NAFTA Chapter 11 provisions that have been carried (with slight modifications) into the US-Chile and US-Singapore FTAs (but excluded from the US-Australia FTA).

Government procurement. Government procurement is a big market, a protected market, and a market close to the political bone. In principle, the United States wants liberalization in the FTAA, but this was not an issue on which progress was made in NAFTA. The objectives of the FTAA procurement negotiations (again from the San Jose Ministerial Declaration) are the following:

- i) *To achieve a normative framework that ensures openness and transparency of government procurement processes, without necessarily implying the establishment of identical government procurement systems in all countries;*
- ii) *To ensure non-discrimination in government procurement within a scope to be negotiated;*
- iii) *To ensure impartial and fair review for the resolution of procurement complaints and appeals by suppliers and the effective implementation of such resolutions.*

From the US standpoint, there are two difficulties. The federal government, as a political matter (not a constitutional matter), cannot bind the states to open their procurement. Moreover, certain kinds of federal purchases might cause a public backlash if opened to foreign suppliers, historically defense procurement, but now outsourcing as well. Some Latin American countries face the same federal/state problems as the United States, but the greater difficulty is the iron triangle between procurement, corruption, and political power. While many Latin American countries are on board for the procurement discussion in the FTAA, others (and all of the Caribbean) wish to limit this negotiating area to that of procedural transparency only, and not to make any commitments on actual government bids.

Trade remedies. In the FTAA, the attempt to discipline trade remedies has been highly contentious. US negotiating latitude was circumscribed by Congress in the Trade Promotion Authority Act of 2002 (TPA), and the United States has been unwilling or unable, or both, to budge an inch in its recently-concluded free trade agreements (or in the current FTAA talks). The NAFTA precedent offers little hope in this regard. During those negotiations the United States likened its countervailing and antidumping duty laws to sacred texts, but agreed as a compromise to a tri-national dispute settlement system to review CVD and AD determinations *made in accordance with national law* (Hufbauer, Schott and Wong, 2003). While NAFTA dispute settlement has worked well in most of the 85 AD and CVD cases reviewed,¹¹ Latin American nations want tighter disciplines.

The stated objectives of the hemispheric agreement set out in the FTAA San Jose Ministerial Declaration are:

To achieve a common understanding with a view to improving, where possible, the rules and procedures regarding the operation and application of trade remedy laws in order to not create unjustified barriers to trade in the Hemisphere.

¹¹ See Hufbauer, Schott and Wong (2003).

This objective clearly allows for the possible revision and rewriting of the rules and procedures governing trade remedy actions in the hemisphere. Like Canada and Mexico, most Latin American nations want to rewrite, and limit, trade remedies, especially antidumping actions. They anticipate that their steel, agriculture, and apparel exports will be especially vulnerable, once US and Canadian tariffs and quotas are dismantled. However, in spite of agreed objectives, the United States has consistently stated, as with domestic agricultural subsidies, that this topic can be negotiated only in the WTO, and that domestic law should not be touched.

Intellectual Property Rights. The United States would like the FTAA to pioneer the next advance in intellectual property rights (IPR). It would like its FTAA partners to agree to the same forward steps that Mexico did during the NAFTA negotiations, when Mexico amended its patent and copyright laws to the satisfaction of the United States and these reforms were subsequently advertised as a model for the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) negotiated in the Uruguay Round.¹² The ways in which the United States (and at times other countries) would like for the FTAA to innovate in this area are : 1) to extend protection in those areas already included in the WTO TRIPS Agreement (i.e. the areas of patents, trademarks, copyrights) by signing additional intellectual property right treaties; 2) enhanced enforcement; 3) through taking into account the technological advances of the Internet for copyright protection and related rights. The stated objective of the FTAA in this area is to:

...reduce distortions in trade in the Hemisphere and promote and ensure adequate and effective protection to intellectual property rights. Changes in technology must be considered.

Most controversially, the United States wants its FTAA partners to accept very strict requirements for the use of compulsory licensing of patented pharmaceuticals provided in the Doha Declaration on TRIPS and Public Health. According to the US Trade Representative, compulsory licensing should be permitted only in the narrowest circumstances. Moreover, FTAA partners should extend the life of pharmaceutical patents to cover “unreasonable delays” in getting marketing approval.

Attitudes have changed since NAFTA and the Uruguay Round with respect to the benefits for developing countries from adhering to tough intellectual property disciplines, and US objectives are difficult for Latin America to accept. Brazil and Argentina, along with most South American countries (Chile excepted), argue that TRIPS conceded far too much to intellectual property owners, mostly multinational enterprises based in developed countries. Argentina and Brazil still have not complied with the TRIPS accord to the satisfaction of the United States. An FTAA chapter on IPR promises to be extremely difficult, though there are aspects of the IPR equation that could be taken on board to somewhat rebalance the unbalanced present situation, including stricter rules on transfer of technology, the protection of folklore and indigenous plant species and varieties along with natural medicines, and long phase-in periods for new enforcement commitments.

Labor and Environment. Countries in the Western Hemisphere that have negotiated or are in the process of negotiating FTAs with the United States understand the political necessity of

¹² See Maskus (2000).

including labor and environmental provisions in the FTAA. However, others still do not, and there is considerable opposition by participants who argue that neither FTAA Ministers nor Heads of State and Government have given a mandate to negotiate on these subjects, despite (or perhaps because of) the objectives set out in the San Jose Declaration:

- a) *To strive to make our trade liberalization and environmental policies mutually supportive, taking into account work undertaken by the WTO and other international organizations.*
- b) *To further secure, in accordance with our respective laws and regulations, the observance and promotion of worker rights, renewing our commitment to the observance of internationally recognized core labor standards and acknowledging that the International Labor organization is the competent body to set and deal with those core labor standards.*

The ultimate battle may not be so much between Latin America and the United States as between the Congress and the President (so long as a Republican occupies the White House). The United States has gone beyond the formula developed in NAFTA in its more recent FTAs with Jordan, Chile, Singapore and Australia. In those FTAs, provisions on labor and the environment form an integral part of the basic treaty and are therefore subject to its dispute settlement proceedings. Each country commits to enforce its own laws, with the possibility of monetary fines or trade sanctions in the event a country engages in a persistent pattern of non-enforcement. However, Congressional Democrats wish to go even further. They want FTAA members to adopt core labor standards (and perhaps core environmental standards); and they want meaningful sanctions to be a realistic outcome. This will be an area of great scrutiny and discussion once the agreement is finalized and comes before Congress for approval, but it is difficult to imagine that such an important political initiative as the FTAA would be denied on the grounds of too lax labor and environment provisions.

It is notable that the FTAA negotiations have no formal working group on these issues. Rather, proposals on the environment and labor have been presented by the United States, and they currently appear in the form of draft chapters of the agreement (chapters VI and VII, respectively, both still in brackets). These are being discussed in the Committee on Institutional Issues (TCI), charged with developing the institutional structure of the FTAA agreement and dealing with all issues of horizontal application. The US draft chapters on labor and the environment are very similar to what was agreed in the US-Chile and US-Singapore FTAs. They contain provisions on the application and enforcement of national environmental/ labor laws, provisions for environmental/ labor cooperation, consultation mechanisms, and disciplines for procedural matters. They allow the right to bring cases before FTAA panels, along with the possibility of trade sanctions if a party does not comply with an adverse panel decision on the enforcement of national laws.

Monetary Cooperation. A subject *not* on the FTAA agenda is monetary cooperation – despite the dismal Latin American record of financial crises and exchange rate instability. The orthodox establishment view – spelled out, for example, by Eichengreen and Taylor (2003) -- is skeptical of currency unions, holding that they are driven more by politics than economics. The right policy framework for the FTAA members, according to this view, entails independent central

banks, inflation targeting, and floating rates. Indeed, this has been the path within NAFTA since the peso crisis, followed with considerable success.

The problem with the orthodox prescription is that it offers no institutional support (within the FTAA context) for moderating financial crises, and it ignores the desperate need for *ex ante* financial surveillance (banks, insurance companies, stock exchanges).¹³ In other words, programs akin to the famous Mexican bailout of 1995 will continue to depend on the pleasure of the United States – pleasure withheld from Argentina in 2001 and grudgingly bestowed on Brazil in 2002. The FTAA can certainly be launched without a monetary chapter, but it is unlikely to thrive for 25 years without action on financial surveillance and commitments to emergency cooperation.

4. *The FTAA a Decade Later – New context*

Despite promises held out by econometric models, the FTAA project has undergone second thoughts during what should be its penultimate year, even as the economic and political context in which it was conceived have evolved over the past decade since the Miami Summit in 1994. Second thoughts on the FTAA vision and objective can be traced to several reasons, which are reviewed below.

Disappointing reforms

At the Miami Summit in 1994, prospects seemed bright for Latin America. “Washington consensus” was the buzzword; reform was in the air; economies were growing; property values and stock markets were rising. All that changed when the Mexican peso crisis erupted shortly after, in late November 1994. Throughout Latin America (with the conspicuous exception of Chile), the second half of the 1990s was marked by financial crisis and slow growth. Taken as a whole, the decade of the 1990s was disappointing. To quote Williamson (Kuczynski and Williamson, 2003, p. 1):

These may not be the worst of times, but few view them as among the best of times in Latin America. The region has lived through another decade of slow growth. Crises seem to have become ever more frequent, with the consequences of the Argentine crisis particularly painful. Poverty fell in the first half of the 1990s but has been increasing again since 1997. Growth in employment in the formal sector has been agonizingly slow. The world economy is in recession, the prices of many primary products were recently at record low levels, and emerging markets are out of favor with investors.

Slow growth in the 1990s was additionally disappointing because, in many dimensions, Latin American policies were reformed. Yet little of the reform effort translated into better growth or lesser poverty. In their detailed review of commercial policies, Bouzas and Keifman (2003) found widespread trade liberalization throughout Latin America during the 1990s, much of it unilateral. Policy progress likewise shows up in the “readiness indicators” calculated by Schott

¹³ On the unmet need for better financial surveillance, see Dobson and Hufbauer (2001).

(2001) for 1994 and 2001.¹⁴ The readiness indicators are composites of five macroeconomic indicators (price stability, budget discipline, national savings, external debt, currency stability) and two market indicators (market-oriented policies, reliance on trade taxes). With the conspicuous exception of Brazil, all large countries improved their readiness indicators, and only a few small countries slipped back.

Despite disappointing growth, the conventional advice to policy makers -- voiced not only by official Washington but also by academic commentators¹⁵ -- is: "carry on". Trade liberalization still features prominently on the Latin American agenda, notwithstanding the election of populist leaders in Venezuela (Chavez), Peru (Toledo), Brazil (Lula da Silva) and Argentina (Kirchner). Continued support for the FTAA can be attributed to the perceived payoff from increased trade and investment, conspicuously evident in Asia, but also in Chile and more recently in Mexico and Costa Rica. Somber economic numbers have, however, translated into harder negotiating stances.

Disillusionment with Globalization

Policy reform and trade liberalization have become less popular in Latin America. A decade ago most Latin American countries had enthusiastically put in place economic reforms flavored by the Washington Consensus, designed to open markets through trade liberalization and privatization. Along with reforms, long-standing prejudices against economic cooperation with the United States went by the wayside. Currently a widespread disillusionment exists about the wisdom of this course of action, since it is widely felt that the reforms did not live up to expected results.¹⁶ Important sectors of society in Latin America and the Caribbean are questioning and resisting further reforms and liberalization and pointing to what they perceive as the failure of the orthodox approach to deliver higher growth, more employment and better standards of living. Even among those that are convinced about the need to maintain the course, there are doubts about the appropriate speed and depth of this process.

The skepticism over further trade liberalization and reform is compounded by the significant deterioration in the economic situation in many countries of the hemisphere during 2001 and 2002. This exacerbates fiscal, social and political constraints, and makes the task more difficult, even for those reformist governments committed to freer trade. It also makes the "selling" of further trade liberalization and economic reform much more difficult in Latin America. And yet, as a recent report by the *Council of the Americas* argues,¹⁷ the FTAA will only become a reality if each government in Latin America and the Caribbean can make a credible case that the FTAA is good for that country, that the FTAA is a key ingredient to restore economic growth, increase employment, reduce poverty -- in short, that the FTAA is an important element of a broader national strategy to reduce the economic and social distress that has been on the rise in recent

¹⁴ For a detailed explanation of the "readiness indicators", see Hufbauer and Schott (1994) and Schott (2001).

¹⁵ Such as Kuczynski and Williamson (2003).

¹⁶ See written remarks by Jose Manuel Salazar on "The Politics and Future of Hemispheric Trade" given at the Yale Conference on Hemispheric Trade, April 4, 2003.

¹⁷ See *FTAA: Blueprint for Prosperity: Building on NAFTA's Success* (2001), Council of the Americas, Washington DC, 36 pages.

years. Fortunately there is a silver lining in the cloud of doubt: a long-awaited turnaround in the form of higher export prices, better economic performance, and strong stock markets throughout most of Latin America in 2003 and 2004.

Doubts About US Negotiating Ability

Latin America and the Caribbean FTAA participants have grown increasingly skeptical as to the real intentions of the United States in the area of trade liberalization. Signs from Washington on the trade policy front have not been positive over the past two years. The Farm Act passed in 2002 appears to mock stated US intentions to actually roll back agricultural subsidies. Instead, it guarantees up to \$20 billion annually in various payments to agricultural producers (the amount of subsidies actually disbursed will vary inversely with the level of farm prices). The Farm Act was carefully drafted not to violate US obligations under the WTO Agreement on Agriculture. Nonetheless the Farm Act sent an adverse signal to Washington's FTAA partners, most of whom are strong agricultural exporters. The signal was amplified when sugar liberalization was all but excluded from the CAFTA agreement with Central America, and entirely excluded from the US-Australia FTA.

The steel safeguard tariffs imposed by the Bush Administration in March 2002 (initially around 24% on average) were declared illegal by the WTO Appellate Body in November 2003, and then removed.¹⁸ However, during the 21 months that the steel tariffs were in place, they reinforced the impression of a US retreat from open markets. In Latin America, Brazil is an important exporter of steel and felt very adversely affected by this unilateral trade action.

Third, the position taken by US negotiators to effectively remove sensitive topics from the FTAA negotiations, notably agricultural production subsidies and antidumping rules, declaring them to be "off-limits" in the FTAA, has given several Latin American countries – again primarily Brazil and its MERCOSUR partners -- good reason to drag their feet on other negotiating areas. The four-tiered structure of the market access offer for goods presented by the United States in the FTAA negotiations has put the MERCOSUR members in the unpleasant position of feeling that they are objects of discrimination, as the tariff reduction schedule and included products are less favorable for them than for other FTAA members. These various factors, taken together, have generated a successful push by Brazil to reorient the entire FTAA negotiations (discussed in the following section).

Fourth, while the passage of Trade Promotion Authority (TPA) in the United States in August 2002 was a cause for satisfaction in several quarters, as it allowed the United States to engage seriously in trade initiatives, it also crystallized the constraints on US trade policy. These include, among others, stipulations that any new trade agreement must be comprehensive and ambitious (and meet the objectives set out in section 2102 of the Trade Promotion Authority Act); that changes to contingent protection (US antidumping and countervailing duty laws) can only be undertaken if the President reports to Congress at least 180 days before signing any trade agreement proposals, to which Congress may disapprove; that any negotiated agreement must contain provisions on labor and the environment which have to figure as an integral part of the agreement and not annexes; and lastly, that negotiation of tariff reduction on a number of

¹⁸ See article "Bush Rescinds Tariffs on Steel" in Washington Post of December 5, 2003.

specified import-sensitive agricultural products (around 130 identified by USTR) need to be notified in advance for consultations with Congress.¹⁹

Lastly, there has been a movement underfoot among several members of Congress to forestall the ability of US negotiators to include any type of commitment on labor mobility in the form of mode 4 (entitled “Movement of Business Persons” under NAFTA and “Temporary Movement of Natural Persons” under the GATS). Key House members wrote a letter to Ambassador Zoellick to this effect in the fall of 2003 and threatened legislation. The sentiment in Congress is so strong that US negotiators were not able to include a chapter on mode 4 in the most recent FTAs with CAFTA and with Australia (signed in December 2003 and February 2004, respectively). All these episodes underline the constraints faced by US negotiators in offering meaningful concessions to Latin America in areas of strong interest. They also put Latin America on guard against significant commitments in areas of interest to the United States, such as services, investment, government procurement and intellectual property rights.

Conflicting Motivations in Brazil

The other major player in the Western Hemisphere besides the United States is Brazil. Though clearly not representing the same degree of overwhelming economic strength, nonetheless Brazil sees itself as the reckoning force in South America. The new government of Ignacio Lula da Silva, through its negotiating arm of Itamarati, the foreign ministry, has apparently decided to use trade policy as its political tool for taking an ideological hard line against what many Brazilians perceive to be the northern imperialist design of economic domination through the FTAA.²⁰ Brazil’s policies have remained highly orthodox in the monetary and financial arenas, reflecting the constraints of outstanding debt and the strictures of IMF programs. So it has fallen to trade policy to become the area where Brazil’s President could take a nationalistic stance, ignoring voices even within his own government that have favored a more accommodating approach. Open dissension with the President’s line was expressed prior to the recent FTAA Miami Ministerial meeting by no less than three Ministers in Brazil – those for Finance, Industry and Agriculture -- but to little avail.²¹ On the contrary, Brazil has forged ahead to use its considerable political and negotiating force to redefine and shape the entire FTAA negotiations, for better or for worse. At the same time Brazil still has the ambition of expanding its influence in South America.

5. *Result: Changing Perceptions of the FTAA*

During 2003 it became evident that the political panorama in the Western Hemisphere had changed, along with the perceptions about the FTAA, and that there was a wide gulf of ambition between several of the participants. Under new governments, Brazil and Argentina, along with

¹⁹ See Title XXI - Trade Promotion Authority - Public Law 107-210, in date of August 6, 2002.

²⁰ See Peter Hakim (2004), “The Reluctant Partner”, in *Foreign Affairs*, Volume 83, No. 1, January/February.

²¹ See newspaper article from the *Jornal do Comercio* (Brazil) on “Presidente Lula convoca reuniao para definir estrategia na Alca em Miami” in date of November 11, 2003.

their MERCOSUR partners shifted rhetoric and tactics to propose a “three-track” approach to the FTAA. According to this proposal, made at the Vice Ministerial meeting in El Salvador in June 2003, certain issues would be dealt with at the multilateral level (domestic support for agriculture, trade remedy disciplines, but also other issues that MERCOSUR was not eager to negotiate such as investment, aspects of services, intellectual property rights, competition policy and government procurement), the remaining issues at the FTAA level, and the market access negotiations on tariffs, agriculture and services would be addressed through a bilateral track.

This proposal stimulated considerable dismay among all the other FTAA participants and threw a roadblock into the forward progress of the negotiations. While most of the other countries were willing to maintain the originally-agreed high level of ambition for the FTAA agreement no matter the consequences, the United States, for political and economic reasons, was unwilling to go forward on the FTAA project without Brazil on board. Serving as co-Chairs of the FTAA process, the two large countries worked out a compromise arrangement for the FTAA that was grudgingly endorsed at the Miami FTAA Ministerial Meeting on November 20th, 2003. Ironically Miami was the location of the original conception of the FTAA in December 1994, and nine years later Miami marked a distinct turning point in the FTAA vision. The original vision of an ambitious single undertaking with substantial disciplines gave way to a two-tiered, more complex agreement. In the process, hemispheric foot-draggers obtained a perceived, but most likely pyrrhic victory.

The “New” Miami Vision

What resulted from the Miami meeting is no longer a one-track, unified agreement but a two-track, double FTAA vision with differing levels of ambition depending upon the track chosen. Gone – at least in the short-to-medium term -- is the notion of a single agreement with uniform disciplines for all the 34 negotiating governments. The decision by Trade Ministers to bifurcate the FTAA process into two negotiating tracks is found in paragraphs 5 through 10 of the Miami Ministerial Declaration entitled “The Vision of the FTAA”. The major innovation in these paragraphs is the introduction of the term “flexibility” in order to accompany the renewed commitment to a “comprehensive and balanced FTAA”.

The Miami Ministerial Declaration recognizes – for the first time in the nine-year process -- that “countries may assume different levels of commitments” and that plurilateral negotiations may be conducted among those countries wishing to take on higher levels of commitments, or those willing to “agree to additional obligations and benefits” (para. 7).

The Declaration insists that the FTAA will still be comprehensive in that it will “include measures in each negotiating discipline, and horizontal measures, as appropriate” (para 9). The Vice Ministers are to develop a “common and balanced set of rights and obligations applicable to all countries”, while interested parties may choose “to develop additional liberalization and disciplines on a plurilateral basis” (para 10). Countries may choose to be a part of the higher-level negotiations at any time they wish by notifying this intention; if they do not wish to take part in the negotiations, they may still attend as observers and become participants at any time thereafter. Importantly, the “results of the negotiations [presumably both of them but this is not specified] must be WTO compliant” (para 10).

The vision paragraphs are intriguing and manage to patch over significant differences in the short run, but they leave open several critical questions. These include:

- What will constitute the FTAA Agreement?
- What will be the legal and institutional linkage between the results of the two sets of negotiations, both of them within the FTAA?
- Will the dispute settlement understanding cover both sets of obligations?
- How will the objectives of “comprehensiveness”, “balanced” and “flexible” be reconciled with one another?
- Operationally, how will two sets of negotiations (one with all 34 participants and one on a plurilateral, voluntary basis) be conducted simultaneously, as the Declaration implies?
- How will the WTO evaluate two sets of FTAA agreements in terms of its requirements for “WTO-plus” in the area of goods and services?
- In what way can a country choose to move from one level of disciplines to the other, and will this be possible on an issue-by-issue basis, or will the entire set of higher obligations need to be accepted as a whole?

The Declaration is unclear with respect to the link between the level of obligations a country would undertake and the market access it would receive, and instead includes ambiguous language setting out the expectation that the agreement “will result in an appropriate balance of rights and obligations where countries reap the benefits of their respective commitments” (para. 8). Additionally, what is not specified in this vision is whether or not the countries taking on the higher level of obligations within the FTAA would extend these to all of the other participants or only to those having signed on to the higher effort. If regional MFN is not practiced within the hemisphere for the two tiers of the FTAA, then the agreement will result in a system of preferences within a preferential arrangement, possibly not only for market access commitments, but also for rules. If countries are additionally allowed to take on different levels of obligations in different negotiating areas according to their desire, this will result in extremely complicated arrangements, hardly conducive to greater intra-regional trade and investment flows.

In summary, the major outcomes of the Miami Ministerial Meeting of end 2003 were to:

- Allow the FTAA process to move forward with all 34 participants still on board.
- Introduce a principle of “flexibility” into the negotiations that had not previously been there.
- Endorse a minimum level of common disciplines for the agreement so as to accommodate all governments, but allow countries that so wish to subscribe to additional liberalization and deeper disciplines on a plurilateral basis.
- Put the FTAA negotiations effectively on a two-track basis with the need to define the procedures for moving forward on this basis

US and Brazilian officials defend their decision to cast aside the single undertaking, claiming that the two-tiered approach affords FTAA governments the requisite flexibility to decide their level of commitment in light of their needs, objectives and capacities. This change is highlighted as necessary to accommodate the changed circumstances and political constraints in the Southern Cone in particular. Ambassador Robert Zoellick has defended the revised vision of the FTAA as giving the MERCOSUR members and the Caribbean countries opportunities to

move forward with trade liberalization that suits their circumstances and, importantly, to use aid to support trade liberalization.²²

The actual negotiations, however, are effectively stalled until the Vice Ministers, under instruction (para 10), are able to unravel the mystery behind the vision statement in the Miami Ministerial Declaration and decide upon the level of base-line obligation that will be acceptable to all participants in each of the nine negotiating groups (and 15 negotiating subjects – tariffs, non-tariff measures, safeguards, rules of origin, customs procedures, standards and technical barriers to trade, agriculture, services, investment, government procurement, competition policy, intellectual property rights, antidumping, countervailing duty measures and dispute settlement). This is a formidable task, given the inability of the same Vice Ministers to reach agreement on several outstanding issues in the past concerning these negotiating areas. The Vice Ministerial meeting held in Puebla, Mexico, in February 2003, took a first stab at this task but adjourned without resolving these thorny questions.

A resumed session of the Vice Ministerial meeting in March 2004 will attempt to put more flesh on the skeleton of the new vision. Vice Ministers must take decisions both on the content of the agreed rules and disciplines for all FTAA participants for the first tier of the agreement, and on the procedures for conducting negotiations at the level of the second tier of the agreement. Difficult questions must be resolved. What role will observers play in the second tier (plurilateral) negotiations, and what rights will new participants have in the plurilateral negotiations if they join at some point before the agreement is finalized? Are new participants entitled to re-open all issues, and thus effectively block the second tier, or must they accept the “negotiated *acquis*”? Moreover, a delicate balance will have to be reached in terms of the depth of disciplines that suit all participants for all areas at the first tier level.²³ Can the first tier outcome both satisfy all FTAA members and meet the requirements of the WTO (cover substantially all trade) and the US Congress (cover labor and environment)? There is a final challenge: How can an ambitious second tier outcome be designed so that all FTAA members will have an incentive to sign on at some future date? Only with a proper design will the FTAA evolve into a truly hemispheric pact, and not a fragmented agreement with adverse commercial and political consequences.

Options for the Future FTAA

The fact that the FTAA process has hit a snag is not necessarily fatal, given that there have been delays and bumps along the way in the completion of several of the multilateral trading rounds as well as of regional trading agreements (for example, the Uruguay Round had to be extended by two years, the Chile-Korea FTA was put on hold for over a year, and the EU-MERCOSUR negotiations are proceeding so slowly that few deadlines are even set any more). A longer time frame might even be beneficial to the FTAA, as it would stretch the negotiations beyond the US

²² See article by Robert Zoellick on “The route from Miami to economic freedom” in the *Financial Times*, December 9, 2003.

²³ See transcript of a background teleconference call by a “U.S. Trade official” regarding the FTAA Trade Negotiations Committee Meeting (TNC) in Puebla, Mexico, February 7, 2004, that appeared in the issue of *Inside U.S. Trade*, February 9, 2004.

Presidential campaign of 2004 and make it easier for the United States to make the kind of concessions that other countries would find essential in order to achieve a balanced agreement. However, the modifications agreed at Miami change the nature of the future FTAA: both the way in which the agreement will be negotiated (along a two-tiered track) as well as the depth of disciplines that it will embrace (some deep, some shallow). These represent significant departures from the original vision. Only time will tell whether the changes prove wise.

What are the options for the FTAA governments in 2004, supposedly the final year of the negotiations? Four options have been set out as possible courses of action:²⁴

- Retain both the scope of ambition and the original schedule of January 2005. (While several countries still adhere to this option – the NAFTA members and the NAFTA sympathizers -- it is seen as too ambitious by the other half.)

Reduce the scope of ambition and maintain the schedule of January 2005. (The option apparently favored by MERCOSUR members.)

- Reduce the scope of ambition and extend the original schedule.
- (The option apparently favored by no one around the table at this point.) Retain the scope of ambition and extend the original schedule. (The option apparently favored by CARICOM members, who feel that it is more important to get a good agreement than to stay on schedule.)

At this point it is difficult to say which of the above four options will ultimately triumph during 2004. Much will depend upon how quickly the Vice Ministers of the 34 FTAA countries are able to define the “base line” disciplines for the agreement that are acceptable to all participants, and in turn when the negotiating groups can begin their work once again.

The Alternative Bilateral Track

Bilateral tendencies, evident for more than a decade both in the global trading system and in the Western Hemisphere, came to the forefront at the Miami Ministerial in November 2003. Even as the Doha Development Round was foundering and missing deadline after deadline in 2003, to ultimately land in Cancun without any clear outcome and considerable rancor, participants in the FTAA process were undergoing their own soul-searching. Several countries continued to link their negotiating stance on certain issues to movement in the Doha Round.

As both of these negotiations have faltered and look problematic, the bilateral track gleamed brighter. Indeed, the temptation to bypass the difficulties inherent in multilateral and regional negotiations, and open a direct path to the giant US market, led many countries to knock on the door of the United States. And they have found it open. On the fringe of the Miami Ministerial Meeting, the United States announced that it would be opening bilateral negotiations with four members of the Andean Community next year – Colombia and Peru at once, while Ecuador and

²⁴ These options were set out by Ambassador Richard Bernal, Chief Negotiator for CARICOM, in a panel discussion on the FTAA negotiations, jointly organized by the OAS and George Washington University's Center for Latin American Studies, on November 25, 2003.

Bolivia would initially be observers but then join as full participants. The US also announced that the Dominican Republic would be added onto the negotiating outcome of the five-member Central American FTA (completed in December 2003), and that negotiations would begin with Panama for an FTA as well in 2004.

In some ways the bilateral announcements could be considered as important an outcome in Miami as the changed vision of the FTAA. Through existing bilateral agreements or ongoing negotiations, the United States has now effectively “captured” all of the countries in Latin America except for the MERCOSUR members. The CARICOM countries already have special access to the US market for most products, under the Caribbean Basin Initiative Act of 2002 (due to expire however in 2007).

This growing web of bilateral FTAs in the Western Hemisphere negotiated by the United States is leading rapidly to the development of a hub-and-spoke arrangement, in which the largest market – the US market – will serve as the hub with the other countries being the spokes. The problem is that MERCOSUR is not part of this wagon at all.

In this way the Miami outcome may prove to be a pyrrhic victory for Brazil, as it may allow for the consolidation of US influence in the Western Hemisphere in a way that Brazil has long tried to counter. This is the view of Peter Hakim of the Inter-American Dialogue, who has written that the Brazilians may in the end turn out to be the losers if the US completes all the bilateral agreements it has pledged to pursue, leaving only Brazil and its MERCOSUR partners on the sidelines (along with Venezuela, Cuba and Haiti), while other Latin American nations secure preferential access to the US market.²⁵ Hakim writes that even if MERCOSUR decided belatedly to negotiate its own deal with Washington, it would still leave the United States at the center of all trade and investment flows in the hemisphere.

7. *Conclusions*

The long journey of the FTAA seems set to arrive, in 2005 or possibly later, at a different station than the one envisaged by the Miami Summit leaders in 1994. The original vision contemplated a grand hemispheric free trade area. The FTAA was not envisaged as the *exclusive* free trade arrangement in the Western Hemisphere, but the vision called for the FTAA to be the *senior* arrangement.

Recent political and economic forces have created a double path. The FTAA will now be two agreements within one, so to speak, with all participants traveling down a wider road and some participants (self-selected) taking a more ambitious and narrower path. What is clear is that the ambition for the common level has been considerably lowered following the Miami Ministerial Meeting of 2003, with some commentators now referring to a “mini-FTAA”. However, even a modest agreement could still represent a landmark achievement if it is able to bring about free hemispheric trade in manufactured goods within ten to fifteen years. Measured against the accomplishments of the GATT system, this is noteworthy. It has taken more than fifty years of

²⁵ Article by Peter Hakim on “America and Brazil both lost out in Miami”, in *Financial Times*, November 25, 2003.

GATT bargaining for trade in manufactures *between industrial countries* to approach (on average) MFN tariffs of around three percent. A mini-FTAA that slashed tariffs on trade in manufactured goods to zero in ten to fifteen years and significantly increased market access in agriculture would compare very well.

Agriculture, services, intellectual property, procurement and investor rights are all important. But export growth in the hemisphere, as in Asia, will surely be centered on manufactured goods. Paring of the original grand FTAA has to be regretted, but an FTAA for manufactured goods counts as worthy achievement. The areas that receive scant treatment on the first tier level of the FTAA will be addressed in depth in the second tier, among like-minded participants. Certainly this will be true of services, intellectual property, investment and procurement, where the more ambitious tier of the FTAA will most likely result in disciplines and access conditions similar to those contained in the recent FTAs negotiated by the United States with Chile, Singapore, CAFTA and Australia. An ambitious tier composed of countries representing nearly 90 percent of the trade in the Western Hemisphere (possibly all but some MERCOSUR and CARICOM members and a few others in the first instance) would certainly create a major vehicle for trade liberalization in the region and could lead, under the right conditions, to the accession of these countries to the more ambitious tier within another five or ten years.

Taken together, both levels of the FTAA, along with the bilateral agreements that continue to profligate, will substantially advance hemispheric free trade and investment, though the outcome is certainly not tidy. The hope is that the disciplines in a large number of these agreements will allow them to converge over time towards each other. This will certainly be the case of the “NAFTA-like countries” under the plurilateral FTAA approach, and may in the future be the case with those remaining outside.

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