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TRADE LIBERALIZATION

Recent Developments in Western Hemisphere Trade Arrangements

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to talk about various issues regarding Western Hemisphere trade liberalization. As you know, the United States is proceeding with discussions leading to a Free Trade Area of the Americas (FTAA) by the year 2005, a goal established at the Miami Summit of the Americas in December 1994. My statement will focus on (1) the principal existing subregional trade arrangements in the Western Hemisphere, (2) the current status of FTAA discussions, and (3) recent developments in regional trade liberalization outside the FTAA process and their possible implications for the United States.

This testimony summarizes our observations in a report to you on these issues being released today.[1] This work was based on (1) our past and ongoing work on Western Hemisphere trade issues; (2) a review of documents on subregional multilateral and bilateral trade arrangements; (3) reports from the FTAA working groups; (4) analyses of regional trade developments from academic and technical publications; and (5) interviews with officials from the Office of the U.S. Trade Representative (USTR), the Organization of American States (OAS), the U.S. International Trade Commission, and representatives from five other Western Hemisphere nations at the forefront of regional trade negotiations.

Before we discuss the specifics of our presentation, we will give you a brief overview.

Summary

While trade agreements in the Western Hemisphere are not new, they have recently been revitalized as more countries in the region have committed to liberalizing their trade regimes. Almost all countries in the region participate in at least one subregional trade grouping, and many have concluded numerous bilateral agreements. There are now six major subregional multilateral trade groupings in the Western Hemisphere. Among these trade blocs, the two most significant are the North American Free Trade Agreement (NAFTA) and the Common Market of the South, known as Mercosur. In addition to these multilateral trade groupings, there are more than 20 bilateral trade agreements involving countries in the hemisphere.

[1] Trade Liberalization: Western Hemisphere Trade Issues Confronting the United States (GAO/NSIAD-97-119, July 22, 1997).

The FTAA, which was called for at the 1994 Miami Summit of the Americas, represents the most ambitious effort in regional trade liberalization to date. At the Miami Summit, regional leaders agreed to establish a free trade agreement encompassing the entire Western Hemisphere by the year 2005.[2] In the last 2-1/2 years, countries have taken numerous steps to prepare for formal negotiations. Trade ministers from participating countries have met three times and have established a number of working groups to address substantive issues, such as market access, services, and investment. The United States has been active in all FTAA meetings and working groups, and chairs the Working Group on Government Procurement.

Substantial agreement has been reached on several key issues in preparation for formal FTAA negotiations. For example, countries have agreed that formal negotiations should be launched by the Western Hemisphere leaders at their next summit scheduled to take place in Santiago, Chile, in April 1998, and that an agreement encompassing the entire hemisphere should be concluded by 2005. Consensus has also been reached on the right of countries to negotiate independently or, if members of subregional trade groupings, as a unit. Moreover, countries agreed to establish a Preparatory Committee at the vice-ministerial level to complete recommendations on the FTAA negotiations early next year. Disagreement remains, however, regarding the pace and direction of negotiations. The United States and most other countries favor immediate negotiations on all issues beginning in 1998. In contrast, Mercosur countries would delay negotiations on certain issues, such as market access, until 2003.

Since the Mexican financial crisis, which surfaced only days after the Miami Summit, the United States has not actively pursued further trade liberalization efforts in the hemisphere. At the same time, other countries have moved forward with a wide range of new free trade initiatives. For example, Canada and Chile recently concluded a free trade agreement. Mexico has also negotiated an extensive network of free trade agreements with countries in the region, including Columbia, Chile, Costa Rica, and Venezuela. Similarly, the Mercosur countries have concluded free trade arrangements with Chile and Bolivia, and they are now entering into trade negotiations with Mexico and the European Union. U.S. exporters' access to markets in the region is starting to be adversely affected by these new trade agreements. Their impact is starting to be felt by U.S. firms in

[2] All 34 democratically elected governments in the Western Hemisphere were represented at the Miami Summit and are involved in the FTAA. Cuba is the only major country in the region that has not participated in the FTAA process.

various sectors, such as agriculture, telecommunications, and the pharmaceutical industry. Whether or not the United States participates in shaping future trade liberalization efforts, representatives of several countries in the hemisphere generally agree that their countries will continue to advance their own regional free trade initiatives.

Background

As the largest regional market for U.S. products, accounting for approximately $242 billion, or 40 percent of U.S. exports in 1996, the Western Hemisphere has assumed growing importance for U.S. commercial interests. Canada and Mexico are by far the largest U.S. trade partners in the hemisphere, accounting for approximately two-thirds of total U.S. exports to the region. The United States is the largest source of foreign investment in the Western Hemisphere, accounting for about 30 percent of total U.S. foreign direct investment.

By the late 1980s, most Latin American countries instituted market-oriented economic reforms to stimulate economic growth and development. Although these reforms were primarily intended to address domestic economic problems, they also facilitated trade liberalization efforts. The 1988 U.S.-Canada Free Trade Agreement, which coincided with Latin America's opening to international trade, signalled a new commitment on the part of North American countries to regional trade liberalization. Currently, almost all countries in the hemisphere are involved in some form of free trade arrangement in what is becoming an increasingly complex web of subregional and bilateral trade groupings.

In launching the FTAA discussions, Western Hemisphere leaders sought to capitalize on the momentum toward regional trade liberalization, bringing together all countries in the hemisphere under a single and comprehensive free trade agreement by 2005. The summit declaration committed participating governments to negotiate the elimination of barriers to trade in goods and services as well as investment and to provide rules in such areas as intellectual property rights and government procurement. Since the summit, trade ministers from participating countries have met three times—in Denver, Colorado (1995), Cartagena, Colombia (1996), and Belo Horizonte, Brazil (1997)—and have effectively laid the foundation for formal FTAA negotiations to begin in 1998.

Western Hemisphere Trade Arrangements

The six major multilateral trading arrangements among countries of the Western Hemisphere are NAFTA, Mercosur, the Andean Pact, the Caribbean

Community, the Central American Common Market, and the Latin American Integration Association. The United States is only a party to NAFTA. There are also over 20 smaller multilateral and bilateral free trade accords among countries in the region.

NAFTA

NAFTA, the most comprehensive trade arrangement in the region, was concluded in 1992 by Canada, Mexico, and the United States and became effective in January 1994. NAFTA created the world's largest free trade area, with a combined population of nearly 400 million and a combined gross domestic product of $8 trillion. NAFTA provides for the gradual elimination of tariff barriers on most goods over a 10-year period. It covers trade in services, provides protection for investment and intellectual property rights, applies rules to government procurement, and contains a dispute settlement system. A distinct feature of NAFTA is the two side agreements on labor and the environment.

Mercosur

Mercosur was created in March 1991 by Argentina, Brazil, Paraguay, and Uruguay. Comprising a population of approximately 200 million and with a combined gross domestic product of about $851 billion, Mercosur is the world's third largest integrated multinational market after NAFTA and the European Union. Mercosur currently functions as a customs union, providing not only for a free trade area but also for the establishment of a common external tariff.[3] Mercosur countries are committed to coordinate macroeconomic policies and to agree on a common foreign trade policy. Unlike NAFTA, Mercosur lacks agreements on intellectual property rights[4] and government procurement.

Other Multilateral Agreements

Besides NAFTA and Mercosur, which were established in the 1990s, there are four older subregional multilateral trade groupings in the Western Hemisphere. Three of these groupings—the Andean Group, the Caribbean Community, and the Central American Common Market—are customs unions at varying stages of implementation. They have all recently taken

[3]According to a USTR official, the World Trade Organization (WTO)'s Committee on Regional Trade Agreements is currently reviewing Mercosur to ensure that it conforms with article 24 of the General Agreement on Tariffs and Trade. Article 24 lays out conditions under which member countries may form preferential trading arrangements, such as customs unions and free trade areas. This official noted, however, that without detailed information on Mercosur's implementation and schedule for liberalization, it is difficult to fully evaluate the agreement under the criteria set forth by article 24.

[4]An August 1995 protocol among Mercosur countries, however, provides limited common terms of reference on intellectual property rights.

steps to further liberalize trade and promote economic integration. The fourth subregional trade arrangement, the Latin American Integration Association, is a network of agreements granting tariff preferences for certain product categories to member countries.

In addition to the larger trade blocs, there are more than 20 smaller multilateral and bilateral trade accords among the countries of the Western Hemisphere. Many of these have been established in this decade.

Status of FTAA Discussions

At the FTAA meetings of ministers in Denver, Cartagena, and Belo Horizonte, 12 working groups were established for the purpose of collecting information to prepare for FTAA negotiations. The areas of responsibility assigned to the 12 FTAA working groups reflect some of the priorities of the United States and other countries in the hemisphere. For example, there are working groups on intellectual property rights and government procurement, issues of key interest to the United States; on subsidies, antidumping, and countervailing duties, areas of special concern to Argentina; and on smaller economies, a priority for Caribbean countries. The United States chairs the Working Group on Government Procurement.

The working groups were established to collect basic information on key issues in preparation for FTAA negotiations. U.S. and OAS officials explained that the working groups have been the mechanism for accelerating progress on the priorities of participating countries. Progress in meeting the information mandates set forth at the ministerials differs for each of the 12 working groups. The Working Group on Investment, for example, is particularly advanced, having prepared a comprehensive technical compendium on investment treaties in the region. According to both U.S. and OAS officials, the Working Group on Investment has also made considerable progress, exchanging views on elements that could be included in a FTAA investment chapter, including investor protection, national treatment, and dispute settlement. Progress in other working groups has been more modest. For example, the Working Group on Market Access reported in February 1997 that many countries had yet to submit the schedules and statistics required to prepare a hemispheric database on tariff structures and nontariff measures.

A Tripartite Committee, made up of the OAS, the Inter-American Development Bank (IDB), and the United Nations Economic Commission on Latin America and the Caribbean, was formed after the first ministerial in Denver to provide analytical support to the working groups as requested. Each organization in the Tripartite Committee is responsible for providing technical support to the FTAA process through the working groups. For example, the IDB is collecting trade statistics to assist the Working Group on Market Access, while the OAS has provided support to other groups on trade policy issues, such as subsidies and competition policy. At this time, the Tripartite Committee's role in support of the FTAA is anticipated to be transitory. The countries are considering the possibility of establishing a temporary FTAA secretariat during the negotiations.

Different Strategies for Pursuing FTAA Negotiations

At Belo Horizonte, consensus was reached on several key issues advanced in these proposals. A joint declaration was issued that called for formal FTAA negotiations to be launched by the next summit of Western Hemisphere leaders scheduled to take place in Chile in April 1998. In the declaration, countries agreed that the FTAA would be consistent with member countries' commitments under the WTO. Moreover, countries agreed that the FTAA would co-exist with rather than supplant existing subregional trade arrangements, such as NAFTA or Mercosur, to the extent that rights and obligations under these agreements are not covered or go beyond rights and obligations under the FTAA. The declaration also recognized the right of participating countries to negotiate independently or as members of subregional trade groupings, and the need to establish a temporary administrative secretariat to support future negotiations. Finally, the declaration reiterated the commitment of participating countries to conclude a trade agreement encompassing the entire hemisphere by 2005 at the latest.

At Belo Horizonte, participating countries also agreed to set up a Preparatory Committee at the vice-ministerial level that will make recommendations for FTAA negotiations. The Preparatory Committee is supposed to meet at least three times between May 1997 and February 1998, when the next FTAA ministerial is scheduled to take place in San José, Costa Rica. At San José, trade ministers are committed to reach agreement on the objectives, approaches, structure, and location of the FTAA negotiations, based on the recommendations of the Preparatory Committee.

Still, there is disagreement among participating countries on the pace and direction of formal negotiations. Most countries, including the United States, would prefer that formal FTAA negotiations on all issues begin during the next summit of regional leaders in 1998 and conclude no later than 2005. The members of Mercosur, however, have proposed that negotiations proceed in three phases: (1) in 1998 and 1999, countries would agree on and begin to implement "business facilitation" measures, such as adopting common customs documents or harmonized plant and animal health certificates; (2) from the year 2000 to 2002, work would begin on "standards and disciplines," including antidumping and countervailing duty rules, and market access for services; and (3) from 2003 to 2005, other disciplines and market access issues would be negotiated, including tariff reductions, a key concern of the United States.

Recent Developments in Regional Trade Liberalization Outside the FTAA Process

In launching the FTAA discussions at the Miami Summit, the United States was building on the momentum for free trade generated by the passage of NAFTA a year earlier. At that time, NAFTA was generally regarded as a blueprint for further trade liberalization in the region. This expectation was also grounded on the anticipated Chilean accession to NAFTA. Only days after the summit, however, Mexico was hit by a serious financial crisis, with spillover effects in other Latin American economies. The commitment by the U.S. government of significant resources to stem and resolve the crisis raised concerns in the United States about further regional trade liberalization efforts. In the intervening period, fast track authority lapsed, and, although U.S. participation in the FTAA preparatory process continued, the executive branch has been constrained from pursuing other tariff liberalization negotiations in the region. Formal negotiations on Chilean accession to NAFTA, for example, were suspended in 1995.

Other Countries Have Moved Forward With Their Own Trade Initiatives

While debate continues in the United States regarding further regional trade liberalization efforts, other countries in the region have proceeded to negotiate new trade agreements and deepen their participation in existing arrangements. Chile has been at the forefront of this trend; it has negotiated a network of free trade agreements with several countries in the region, including Colombia and Venezuela. In 1996, Chile concluded a free trade arrangement with Mercosur, becoming in effect an associate member of that trade bloc.

Chile's pursuit of free trade is not limited to South America. The Canada-Chile Free Trade Agreement, which became effective on July 1 of this year, is modeled on NAFTA and is intended as a provisional agreement to facilitate Chilean accession to NAFTA. Nevertheless, there are some notable differences between this bilateral agreement and NAFTA, reflecting some of the areas where Chilean and Canadian interests differ from those of the United States. For example, under their bilateral agreement, Chile and Canada are committed to forgo imposing antidumping and countervailing duties within 6 years after the agreement goes into effect.

Mexico has also been extending its own web of bilateral trade agreements throughout the hemisphere. It has concluded bilateral free trade agreements with Costa Rica and Bolivia, and has a trilateral arrangement with Columbia and Venezuela. Mexico is also negotiating free trade agreements with Ecuador, El Salvador, Guatemala, Honduras, Panama, and Peru. In addition, it plans to negotiate a transitional agreement with Mercosur that will cover key areas, such as market access, government procurement, intellectual property rights, and investment.

Mercosur has also been active in subregional trade initiatives since the Miami Summit. In addition to its arrangement with Chile, Mercosur has concluded a free trade agreement with Bolivia and is engaged in negotiations to widen its reach to other Andean Group countries. Mercosur has also concluded a framework agreement on trade with the European Union and is scheduled to begin formal trade negotiations with Mexico in December 1997.

Mercosur has not only been broadening its network of agreements with other countries, it has also been deepening the level of economic integration among the four original member countries. In 1995, Mercosur countries instituted a common external tariff, which is currently applied to about 85 percent of imports from outside the bloc. Trade among Mercosur member countries has almost tripled, from approximately $5 billion in 1991 to $14.5 billion in 1995.

Some U.S. Sectors Feel Impact of Other Subregional Trade Agreements

Lack of U.S. participation in shaping emerging Western Hemisphere trade agreements has created disadvantages for some U.S. exporters' access to these markets.[5] By lowering or eliminating tariffs among participating countries, subregional free trade agreements that exclude the United States result in comparatively higher duties for U.S. exports. For example,

[5]These examples of select sectors illustrate cases where U.S. export opportunities have been adversely affected by subregional trade agreements. A broader evaluation of the costs and benefits of increased trade and specific trade agreements requires a consideration of both U.S. export and import-competing sectors. While trade liberalization has historically created net benefits to the aggregate economy through improvements in efficiency, it creates costs that fall more directly on certain sectors of the economy and labor force.

Chile's network of bilateral trade agreements has given Chilean agricultural products an edge over U.S. exports in South America. Thus, while Chilean apples enter many South American markets duty free, Washington State apples face 10 to 25 percent tariffs. In recent years, Washington growers have seen their share of these markets dwindle as Chile capitalizes on its tariff preferences.

Like Chile's arrangements with other South American countries, the Canada-Chile agreement has already yielded benefits for Canadian firms not enjoyed by U.S. companies. Recently, Canada's Northern Telecom won a nearly $200-million telecommunications equipment contract in Chile. According to the State Department, the choice of Northern Telecom over U.S. companies was at least in part due to the fact that buying from a U.S. producer would have meant an additional $20 million cost in duties relative to purchasing from Canada.

While U.S. exports to Mercosur countries have been growing, U.S. exporters will likely face increasing difficulties in penetrating markets in Mercosur countries as commitment to common bloc trade policies deepens. For example, a USTR official noted that Mercosur is currently considering adopting product safety standards that are quite different from U.S. standards. This official explained that if these standards are adopted, U.S. auto manufacturers could be at a disadvantage in accessing the growing markets of Mercosur member countries.

Mercosur's position on the recent WTO Information Technology Agreement also provides an indication of how the bloc's common foreign trade policy will complicate U.S. efforts to promote its economic interests in the region. The Information Technology Agreement, which was signed by 28 WTO members in Singapore in December 1996, provides important tariff concessions in an industry where the United States enjoys a considerable competitive advantage. Brazil did not join in the Information Technology Agreement, seeking to protect its own emerging information technologies industry. Brazil's position on the agreement has now been adopted as an element of Mercosur's common external trade policy, while other partners like Argentina, if acting individually, might have taken a different position.

The difficulties faced by the U.S. pharmaceutical industry in the Argentine market also illustrate some of the drawbacks encountered by U.S. firms as countries in the region drift away from the long-standing U.S. concern regarding intellectual property protection. In a recent statement before the

Trade Subcommittee of the House Ways and Means Committee,[6] the President of the Pharmaceutical Research and Manufacturers of America estimated that annual losses by member companies due to patent infringement in Argentina amount to several hundred million dollars. This official noted that NAFTA has the strongest safeguards for intellectual property rights of any trade agreement. He concluded that if Argentina had been brought into NAFTA, that government would have had to seek to curtail patent infringement more decisively than it does now. It is worth noting that Argentina's former Finance Minister favored joining NAFTA rather than integrating further within Mercosur. However, after NAFTA negotiations with Chile were suspended, it became clear that prospects for Argentine accession to NAFTA were rather distant, and Argentina proceeded to cement its position within Mercosur.

Regional Trade Liberalization Likely to Continue Regardless of U.S. Participation

Other Western Hemisphere leaders have indicated their countries will continue their initiatives toward free trade and economic integration. For example, a Chilean trade official told us that, like the United States, Chile would like to see the widest and most comprehensive agreement possible on free trade for the Western Hemisphere. However, this official noted that whether through NAFTA or the FTAA, with or without the United States, Chile intends to continue to pursue trade liberalization because it is seen as furthering Chile's own interests. Chile still wants to join NAFTA, but NAFTA is now less critical to Chile than it was in 1995.

Like Chile, Canadian interests in regional trade liberalization generally coincide with those of the United States. However, the recent Canada-Chile free trade agreement demonstrates that Canada is pursuing its commercial interests in the region. According to a Canadian government spokesman on trade policy, Canada's free trade agreement with Chile was not only meant to expedite Chilean accession to NAFTA, but it was also intended to keep alive the momentum for free trade in anticipation of FTAA negotiations. Canada would like to see decisive U.S. participation in FTAA negotiations because the two countries share many interests with regard to trade.

Mexico's interests in regional trade liberalization parallel those of Chile and Canada. According to Mexican government trade officials, all of Mexico's agreements and negotiations with other countries in the hemisphere have sought to encourage the adoption of trade disciplines consistent with NAFTA. These officials explained that Mexico has actively

[6] March 18, 1997.

supported Chilean accession to NAFTA and the concept of a free trade agreement that would encompass the entire hemisphere. Moreover, they noted that Mexico is committed to the principles of free trade and will continue to pursue free trade arrangements with other countries in the hemisphere and other regions.

In contrast to our NAFTA partners and Chile, the Mercosur countries' vision of the FTAA differs significantly from that of the United States. As the largest member of Mercosur, Brazil has sought to shape the FTAA process to make it consistent with its distinct trade priorities. Since the FTAA would entail broadening Brazil's ongoing market-opening efforts, Brazil favors a slower managed approach to hemispheric trade liberalization. Thus, Brazil has proposed that FTAA negotiations on market access be deferred until 2003, while the United States would like to see this matter addressed as soon as negotiations begin in 1998. A Brazilian government spokesman noted that, at a minimum, FTAA negotiations in 1998 could include items such as common customs documents, which would not require legislative approval. However, if that is the extent of the negotiations, discussions on market access would be deferred, as favored by Mercosur.

In conclusion, it appears that trade liberalization among countries in the Western Hemisphere will continue in the near future regardless of U.S. involvement. U.S. exporters' access to markets in the region is already being adversely affected by these new trade agreements. U.S. involvement in shaping the FTAA and other regional trade arrangements is likely to play a key role in determining how U.S. exporters will fare in Western Hemisphere markets in the future.

Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. We will be glad to answer any questions you may have.

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