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HEMISPHERIC ECONOMIC INTEGRATION AND THE FREE TRADE AREA OF THE AMERICAS (FTAA)

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HEMISPHERIC ECONOMIC INTEGRATION AND THE FREE TRADE AREA OF THE AMERICAS (FTAA)[1]

Highlights

- The Western Hemisphere has seen a proliferation of regional and bilateral trade agreements during the past two decades.

- These agreements, while contributing to a significant lowering of tariff rates and to increased trade openness, have spun a complex web of hemispheric economic integration in the region. A key objective of the Free Trade Area of the Americas (FTAA) is to design a comprehensive trade liberalization framework for the entire region.

- FTAA negotiating countries have much to gain from a hemispheric free trade deal, especially greater economic efficiency and higher incomes resulting from reductions in trade barriers.

- Canada, while enjoying reasonably secure access to the United States and Mexico markets through its membership in NAFTA and advantages accruing from its membership in bilateral trade agreements in the Americas, also stands to receive direct trade and investment benefits from a successful completion of FTAA negotiations.

- Key potential obstacles to an FTAA agreement remain. They include the need for Brazil and the United States to craft a mutually acceptable arrangement; economic and political instability within South America; negative public opinion surrounding trade liberalization; and the concurrent pursuit of trade negotiations at the hemispheric (FTAA) and multilateral (WTO) levels.

- The success of the FTAA negotiations will largely hinge on the successful resolution of market access issues. Other key negotiating issues include the needs of small economies, which comprise three-quarters of potential FTAA members; investment; labour and environment standards; and the transparency of the actual negotiations.

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(1) This paper draws on the June 2002 report of the Sub-Committee on International Trade, Trade Disputes and Investment (*Strengthening Canada's Economic Links With The Americas*), co-authored by Peter Berg and Michael Holden of the Economics Division, Parliamentary Research Branch, Library of Parliament.

The last several decades have seen proliferation of regional and bilateral trade agreements throughout much of the world. These include a number of high-profile arrangements such as the North American Free Trade Agreement (NAFTA), the European Community and Mercosur (the Southern Cone Common Market), as well as some lesser-known agreements.

These developments have provoked a strong debate about the merits of regional trade agreements. Some economists claim they can exert negative economic effects, in that they can divert trade from lower-cost sources outside a trading bloc to higher-cost internal sources. Regional agreements can also detract from efforts to attain multilateral free trade, which is generally recognized to represent the optimal trade situation.

Others believe that regional free trade can be an important "second-best" alternative to multilateral free trade. Regional agreements can generate significant economic benefits, especially in the form of higher incomes and increased trade within trading blocs. This, in turn, could draw in more imports from outside the blocs. As well, the negotiation of regional trade agreements can serve as a valuable accelerating force for trade talks at the multilateral level. For example, free trade developments in North America likely advanced progress during the Uruguay Round of multilateral trade negotiations.

Within the Western Hemisphere, countries have adopted a multi-track approach to trade negotiation.(2) They have shown support for the World Trade Organization (WTO), while also entering into regional and bilateral trade agreements. With the establishment of a Free Trade Area of the Americas (FTAA), these regional trade liberalization efforts would be brought together to form a hemispheric free trade zone.

This paper has three main sections. First, it outlines efforts undertaken to date to achieve hemispheric economic integration. It then covers some of the key opportunities and challenges associated with the hemispheric free trade initiative, keeping Canada's interests in mind. Finally, it discusses a number of important FTAA negotiating issues.

HEMISPHERIC INTEGRATION TO DATE

During the past two decades, Latin America has embarked on an extensive program of trade liberalization and broader economic policy reform. Regarding the former, the efforts of Latin America and the Caribbean to take advantage of trade liberalization, as well as

(2) J.F. Hornbeck, *U.S.-Latin American Trade: Recent Trends*, CRS Report 98-840 E, Congressional Research Service, Washington, D.C., 4 April 2001, p. 5.

economic and social integration, have led to more than 50 trade agreements in the Western Hemisphere. These include a number of regional groupings of like-minded countries in that part of the world, as well as bilateral initiatives.

In freeing up trade, the region has adopted the approach of "open regionalism." This concept provides for the creation of sub-regional preferential agreements that are designed not to block out new members, or members' bilateral agreements with outside countries.(3) The concept also enjoins member countries to refrain from implementing industrial policies aimed at protecting domestic industries against foreign competition.

Along with unilateral trade liberalization decisions and an extensive number of bilateral agreements, these sub-regional agreements have lowered average Latin American tariff rates from over 40% in the mid-1980s to less than 12% in 1999. Trade openness, as measured by the ratio of imports to GDP, doubled from 10% to 20% over the same period.(4)

The most significant of the regional groupings, in terms of size and economic strength, are the Southern Cone Common Market, the Andean Community, the Caribbean Community and Common Market, and the Central American Common Market. Since 1990, these have registered substantial progress in lowering intra-regional trade barriers.

The **Southern Cone Common Market (Mercosur)** was established in 1991 and comprises Argentina, Brazil, Paraguay and Uruguay. Mercosur is the largest economic market in Latin America and the Caribbean, and the second-largest preferential trading group (behind NAFTA) in the hemisphere. Its four member countries are home to 217 million people and its combined GDP is about $1.5 trillion, nearly equivalent to that of India – the fifth-largest economy in the world.

On 1 January 1995, Mercosur formally entered into a customs union after several years of negotiation. Bolivia and Chile joined the union as associate members in 1996. This customs union has rendered trade duty-free for roughly 90% of all products.

Currently, Mercosur is working towards the free circulation of goods, services, capital and labour across the four countries, as well as a common external tariff (CET) and the harmonization of macroeconomic and sectoral policies. This process is under way and expected

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(3) J.F. Hornbeck, *A Free Trade Area of the Americas: Status of Negotiations and Major Policy Issues*, CRS Report RS20864, Congressional Research Service, Washington, D.C., 27 March 2002, p. 1.

(4) *Ibid*, p. 1.

to be completed by 2006. However, economic and political complications in Brazil in the late 1990s and ongoing turmoil in Argentina have created internal divisions within the grouping.

The **Andean Community** is a common market dedicated to economic and social integration across its member countries. It comprises five countries in the northwest of South America: Colombia, Peru, Venezuela, Ecuador and Bolivia. The Andean community is a significant economic presence in South America. Generously endowed with natural resources, the region is home to 105 million people and contributes over $286 billion to global economic output.

The region has worked to liberalize trade in both its internal and external markets. The Andean Community became a free trade zone in 1993 and adopted a CET in 1995. The average tariff on goods entering the region was 13.6% in 1998, down from 33% in 1989.

The **Caribbean Community and Common Market (CARICOM)** consists of 14 Caribbean countries, plus the Bahamas, which is part of the Caribbean Community but not the Common Market. CARICOM has agreed to implement a CET over a period of six years, although members will be able to maintain their own non-tariff barriers.

The **Central American Common Market (CACM)** was created in 1961 but became energized only following a 1990 meeting of Central American Presidents. Four members of the CACM, known collectively as the Central American Group of four (El Salvador, Guatemala, Honduras, and Nicaragua), have taken steps to liberalize and harmonize their trade regimes.

Despite Latin America's success with "open regionalism" in promoting trade liberalization, the region's numerous trade agreements continue to be viewed as a complex web of inefficient arrangements that can have certain discriminatory effects. Much of the motivation behind the negotiation of an FTAA lies in a desire to simplify the current situation.

THE FREE TRADE AREA OF THE AMERICAS: BENEFITS, OBSTACLES AND KEY ISSUES

Canada, along with 33 other countries in the hemisphere (excluding Cuba), is currently negotiating a Free Trade Area of the Americas (FTAA). If successful, these negotiations would result in the creation of the world's largest free trade area, containing over 800 million people and generating a combined GDP of almost $17 trillion (over US$11 trillion). Ideally, the FTAA would promote economic integration by creating a comprehensive (presumably WTO-plus) framework for lowering tariff and non-tariff barriers to trade and investment. Without a doubt, negotiation of an FTAA would represent a major accomplishment.

The FTAA would build on Canada's free trade links with the United States, Mexico, Chile, and Costa Rica, and the agreement would co-exist with prior trade deals such as NAFTA. In essence, our trade with the United States and Mexico would continue to be governed by NAFTA, unless all three NAFTA members agreed to FTAA superiority.

The proposed FTAA is also an integral component of the Summit of the Americas (SOA) process that links economic growth to social development in raising standards of living, improving working conditions and better protecting the environment throughout the Americas.

The concept of a free-trade area encompassing the Americas was first proposed in 1990 by then U.S. president George Bush Sr. as the Enterprise for the Americas Initiative. It came on the heels of the signing of the Canada-U.S. Free Trade Agreement (FTA) and the beginning of negotiations on what would become NAFTA.

The idea was revived as the FTAA at the first modern-day Summit of the Americas, held in Miami in 1994. The heads of state and government of 34 countries of the Western Hemisphere discussed the advancement of economic prosperity, democracy and development in the Americas. At that Summit, all countries agreed to conclude an FTAA by 2005. It was later proposed that the deadline be moved up to 2003; Canada and several other countries supported this suggestion, but it was not adopted. Formal FTAA negotiations were launched at the 1998 Santiago Summit. The current timetable is to conclude the negotiations by January 2005 and implement the FTAA by December 2005.

There are diverging views on the 2005 deadline. Some see it as an overly ambitious target that will not be met owing to a host of current obstacles. Others believe that while 2005 is an ambitious deadline, it could be met if the negotiations proceed well. There are ongoing signs that the negotiations are indeed progressing steadily.

A. FTAA Benefits

The Western Hemisphere has slightly less than 15% of the world's population, but conducts more than 35% of the world's measured economic activity. With a population of over 800 million people and a combined GDP of over US$11 trillion, the Americas region is by far the largest and most productive economic region of the world. It surpasses by more than US$3 trillion the European Union (EU), the second most important economic region.

The principal aim of the FTAA is to increase trade, investment and economic growth throughout the Americas. In addition to freeing up trade in goods, the FTAA could also increase access to countries' services sectors and implement stronger investment protection measures.

1. Economic Benefits to the Americas Region

The countries of the Caribbean, Central America and South America have much to gain from a hemispheric free trade deal, notably greater economic efficiency and higher standards of living arising from reciprocal reductions in trade barriers. Most important is the enhanced access to the large North American and Brazilian markets that an FTAA would create. In particular, achieving preferential access to the large U.S. market is a huge incentive for countries of the Americas to remain active in the FTAA negotiations.

An FTAA would also provide smaller countries of the Americas with the rules and dispute-settlement mechanisms that they need to do business confidently with their trade and investment partners, thereby promoting economic stability. Even nations as open to the world as Chile would like to see progress made in certain key areas such as investment and services. Success at the hemispheric level would ultimately also free up valuable trade policy resources now being consumed by economic relationships at the bilateral level.

A final and perhaps lesser-known observation is that many of the developing countries would stand to benefit internally from entry into an FTAA. For example, free trade agreements can bring about the institutional changes (e.g., tax reform, and proper application of the rule of law) that are often required to modernize an economy. A prominent Canadian advocate of free trade has noted that "it is exactly those nations with the shakiest democracies and weakest rule of law that will most gain from the legal obligations for transparency and predictability required by FTAA, and that one of the areas to benefit most from this will be environmental regulation."(5) Enhancing the level of economic integration can also help prevent

(5) *NAFTA Tenth Anniversary Study: Looking to FTAA and the Future*, joint proposal of the Fraser Institute and the Hudson Institute, August 2001, p. 5.

any backsliding of the economic and political reforms that have already occurred throughout the hemisphere.(6)

2. Benefits to Canada

On the surface, there is no apparent need for Canada to embark on another hemispheric trade initiative. The United States now accounts for about 87% of Canada's total exports and about 64% of total imports. Add in the other hemispheric countries with which Canada has a free trade agreement (Mexico, Costa Rica and Chile) and one can account for 98% of our hemispheric exports.

However, there are a number of important reasons for Canada (and others) to sign on to an FTAA. First, the direct trade and investment benefits are still worth exploring. The raison d'être of all free trade agreements is to increase the size of the economic pie – to improve prosperity and well-being. Firms in export-oriented sectors of the economy are not the only ones to benefit from trade liberalization. On the import side of the trade equation, the gains from trade include the increased competitiveness of companies importing products and services as inputs to their manufacturing processes, and the greater satisfaction accruing to Canadian consumers from imports of consumer goods and services from abroad. Free trade should lower the price of many of these imports.

While the United States and Mexico dominate Canada's trade relations with the Americas, Canada has also seen a rapid expansion in its economic relationship with countries in South and Central America, as well as with the Caribbean. In part a result of its bilateral free trade agreements and Foreign Investment Protection Agreements (FIPA) in the region, Canadian investment in non-NAFTA countries of the Americas has soared since 1990 and trade has followed suit. Outward investment by Canadian firms has been shown not only to generate domestic economic expansion, but also to stimulate export growth as a market for exported goods and services is created. Indeed, Canada has seen faster growth in exports with these countries over the 1990s than with any other region of the world.

Even excluding Canada's NAFTA partners, the Latin American and Caribbean region was a $4.2-billion export market for Canadian goods in 2001, representing roughly 8.7%

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(6) Raymond J. Ahearn, *Trade and the Americas*, CRS Issue Brief IB95017, Congressional Research Service, Washington, D.C., 6 November 1998, p. 5.

of our total merchandise exports to non-NAFTA countries. As well, the region displays significant long-term potential as a market for both Canadian goods and services, with a total population of around 500 million and a GDP in the order of US$2 trillion. In recognition of the economic opportunities in the Americas, Canada continues actively to pursue a policy of removing obstacles to doing business in that region of the world and opening those markets to Canadian investors and entrepreneurs.

Second, Canada is aiming to enhance market access for Canadian exporters through the elimination of tariffs. While a full 94% of current imports from FTAA countries enter Canada duty-free, some Canadian exports (e.g., paper products, technology products, auto parts, and potash) face significant tariffs (up to 30%) in the region. Currently, average import tariffs in Latin America, at 12%, are high. Elimination of tariffs on all products, with limited exceptions and a phase-out time frame of no more than 10 years, would help to boost exports and lower Canada's overall trade deficit with the region.

Third, Canada continues to be a major investor in South America, especially in the natural resources and telecommunications sectors, and in the Caribbean. Canadian foreign direct investment (FDI) in the Americas reached an estimated $268 billion in 2001. While the main destination for Canadian FDI between 1989 and 1999 was the United States, Canadian FDI in non-NAFTA countries in the Western Hemisphere during that period rose from $7 billion to nearly $66 billion, significantly outpacing the growth of Canadian direct investment in the United States.(7)

Given that Canada has a strong outward investment orientation in the Americas beyond NAFTA, it is not surprising that this country would have a keen interest in seeking a rules-based, secure and predictable environment for investors and their investments in the hemisphere. The FTAA could provide that environment. Ideally, the commitments on investment would, with certain possible exceptions, at least reflect those already found in existing sub-regional and bilateral agreements. Ultimately, the principal objective is to achieve non-discriminatory treatment of Canadian investment and businesses operating throughout Latin America.

Finally, it is not in Canada's best interests to continue to face the patchwork of free trade agreements that currently exists in the Americas. This situation results in differential

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(7) On the incoming side, about 70% of foreign direct investment in Canada comes from the Americas, of which the lion's share (over 95%) comes from the United States. In 1999, the amount of inward FDI in Canada originating in non-NAFTA countries totalled only $3 billion.

access to the Americas market for the three NAFTA members. Realization of an FTAA would ensure greater uniformity of rules and common access throughout the Americas.(8)

3. Extending the Frontiers of Trade Agreements

The FTAA also provides an opportunity to extend the frontiers of trade agreements (e.g., streamlining customs procedures to clarify the rules and simplify transactions for producers and traders, competition policy, opening government procurement markets). Ideally, the agreement would also include such useful elements as clear and predictable rules of origin that ensure that the benefits of the agreement accrue to goods produced in the hemisphere, as well as progress on non-tariff barriers and technical barriers to trade such as standards and phytosanitary measures. The FTAA could even serve as an important regional stimulus to the negotiations currently under way at the World Trade Organization. Progress in all these areas is of critical importance to an open economy such as Canada's.

Over the past eight years, NAFTA has demonstrated its effectiveness not only in increasing trade and investment flows across member countries but also, as the case of Mexico shows, in promoting economic growth in developing countries. Canada's ongoing pursuit of trade liberalization and economic integration with other countries in the Americas provides an opportunity to reinforce the positive aspects of existing free trade agreements, particularly NAFTA, while at the same time improving upon some of the less successful aspects of those models, such as the provisions on investment protection and on anti-dumping and countervailing duties.

4. Enhancing Peace and Political Stability in the Americas

There are also geopolitical benefits associated with closer hemispheric ties. The most important is the enhancement of stability in the region.

B. Obstacles to the Achievement of an FTAA

At this point in the negotiation process, it is unclear whether the FTAA will be realized by 2005. There exist a number of key obstacles to the successful negotiation of this treaty. Some of the current FTAA uncertainty lies with the U.S. tendency to resort to

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(8) *Toward 2005 – and a Free Trade Area of the Americas*, Alliance of Manufacturers & Exporters Canada, Presentation to the Standing Committee on Foreign Affairs and International Trade, 21 April 1999, p. 2.

protectionist measures and trade remedy laws, and the attitude of other countries (especially Brazil) to those market-limiting moves. It is most unfortunate that the previous optimism surrounding the FTAA appears to have been shattered by this U.S. approach.

A second potential obstacle lies in the uncertain attitude towards the FTAA of Brazil, Latin America's largest economy. Recent elections there may have added to this uncertainty.

Other factors to consider include the economic and political instability in the region, public opinion about a hemispheric free trade pact, the problems associated with conducting negotiations involving 34 countries, and the 2001 launch of a new WTO round. These are all discussed below.

1. Recent Protectionist Action and Latin American Responses

Throughout the Americas, concerns have been expressed about the U.S. attitude towards free trade and protectionist action in such sensitive sectors as agriculture, steel and textiles. Specific mention has been made of the U.S. Farm Bill that has now been signed into law by President Bush, and the American decision to restrict steel imports. The Farm Bill authorizes a total of approximately US$180 billion in new farm spending over the next decade, an increase of nearly 80% over the cost of continuing existing programs. The new legislation, which completely reverses the subsidy-slashing 1996 Freedom to Farm Act, also imposes country-of-labelling requirements on products sold in the United States, to be mandatory by 30 September 2004. President Bush has also authorized the placement of duties on imported steel under Section 201 of the *Trade Act of 1974*.

In Latin America, calls have gone out for greater American leadership in global trade issues and a more coherent approach to U.S. trade policy. A dominant view in Latin America is that the United States' continued active involvement in official discussions on the FTAA does not square with recent moves by that country to protect its domestic industries from foreign competition. According to this view, considerable political will must be demonstrated by the United States for a truly successful FTAA to be achieved.

Recent U.S anti-dumping and countervailing duty actions on steel and softwood lumber imports have also raised concerns about the appropriate use, and even the validity, of these trade remedies. In Brazil, government officials and business groups have expressed their opposition to these protectionist measures. Fearing that anti-dumping and countervail provisions could be used to limit access to U.S markets, many in Brazil have called for them to be abolished or at least heavily modified in subsequent free trade agreements.

This view has been echoed in other Latin American countries. In Chile, for example, government officials maintain that dumping is illogical in a true free trade zone since all participating countries are part of the same market. While Chile has defended itself successfully in the past against anti-dumping charges, officials there have cautioned that this was a costly, difficult and time-consuming process, one that is especially challenging for developing countries with limited resources.

2. Brazil's Desire for an FTAA

Brazil's economy, almost the size of China's, accounts for one-third of Latin America's economic output and is an anchor of stability in the region. It represents one-half of the new market that an FTAA would open for Canada. It is self-evident, therefore, that a hemispheric free trade grouping without Brazil would lack credibility.

Until recently, Brazil's preferred FTAA strategy appears to have been to first consolidate a bloc within South America through its leading role in Mercosur and then negotiate a trade agreement on a more equal level.[(9)] With the recent collapse of the Argentinian economy, however, this strategy may have now run its course.

While Brazil has been very much involved in the FTAA negotiations, especially in the areas of market access and agriculture, it remains unclear whether it will sign on to a deal. Brazil views FTAA negotiations primarily as bilateral discussions between itself and the United States. However, Brazil is skeptical that the United States will deliver meaningful market access and tariff reduction.

Many in Brazil see the current negotiations as a one-sided affair, with Brazil seeking substantial access to the very sectors of the U.S. economy (e.g., the agricultural sector) that the United States is attempting to protect. As it stands now, whereas the average U.S. tariff is a mere 3%, the average tariff on the top 15 Brazilian exports to the United States totals 44%.

In addition, the Brazilians are opposed to recent U.S. farm policy and to the anti-dumping procedures that protect, for example, U.S. steelmakers. The Americans, however, are

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(9) "*Getting Over The Jet-Lag*": *Canada-Brazil Relations 2001*, Canadian Foundation for the Americas, Policy Paper FPP-01-3, p. 5.

unwilling to negotiate changes in these areas, arguing that such discussions should take place at the WTO level.

As a result, public opinion in Brazil now seems to view the FTAA as benefiting primarily the United States, in that Americans will gain greater access to Brazil's market but not vice versa. Brazilians remain fearful of U.S. competition and are reluctant to concentrate their geographical trade patterns in the Americas.(10) Simply put, Brazil does not believe that its economy is at the point where it can effectively compete with other countries. This goes a long way to explaining the country's lukewarm attitude towards the FTAA.

A key difficulty is that the Brazilian government would have to deal with the concerns of powerful domestic industrial lobbies prior to reaching a deal. Brazil's economy is highly protected, with import tariffs averaging almost 15%. Even higher tariff levels and restrictions protect large industries such as automobiles, chemicals, pharmaceuticals and computers. Much of Brazilian industry remains unsupportive of the FTAA.

Yet another issue is that of sovereignty. Brazil often views itself as the United States of South America and, as such, may be unwilling to trade off too much sovereignty for the benefits that an FTAA can bring. Many Brazilians fear that a hemispheric free trade agreement would erode national sovereignty and result in too much American control over foreign policy and domestic decision-making.

In the end, however, it is considered likely that Brazil would sign on to an agreement if the deal was good for that country. If issues such as market access for agricultural products (e.g., the removal of phytosanitary controls on orange juice) and the tightened use of anti-dumping measures (i.e., steel) were addressed in the FTAA agreement, then the Brazilians might very well be flexible.

One development that could augur well for the future of the FTAA is that Brazil and the United States are to co-chair the finishing two-year phase of the negotiations, beginning in November 2002. This will place the two powerful adversaries in a position of considerable authority to hammer out a deal that is acceptable to both sides.

It is well known that in the negotiations Brazil is seeking much greater access to the large American market for its agricultural products – through the reduction of high price supports that undercut Brazilian exports as well as import restrictions – and manufactured goods.

(10) In fact, they seem to be currently fixated on the Europeans.

This desire to demand a price for freer trade will undoubtedly increase with the election of a new president in Brazil (see below). However, any withdrawal from the negotiations would be a setback for Brazil in progress towards its objectives, and would eliminate the prospect of any gains realized as a result of Brazil's co-presidency of the negotiations. For its part, the United States is seeking, among other things, reductions in Brazilian tariffs on capital goods (currently averaging 12-14%) and other products. The likely solution, if one is to be attained, is a lengthy and gradual market opening, perhaps spanning a period of 10-15 years.

3. Economic and Political Instability in the Region

A number of South American countries are currently experiencing significant economic and/or political turbulence. Argentina is in the midst of yet another economic and political crisis, raising new concerns about the viability of the FTAA process. Colombia and Venezuela have also displayed considerable political instability.

Brazil is currently undergoing political change with the election of a new president (Luiz Inacio Lula da Silva, commonly known as Lula) on 27 October 2002. Lula's economic policies appear to be oriented towards creating employment, raising living standards and keeping a watchful eye on U.S. corporate activity in Brazil. The international financial markets, as well as those in Brazil, have been apprehensive about Lula's election to the presidency.

Evidently, all this instability is causing uncertainty with respect to the free trade negotiations. However, it is not clear whether the current turbulence in Latin America will be enough of a factor to block the FTAA from being realized. It may delay the deal beyond 2005, but many believe that it will not deny it.

4. Public Opinion

Public opinion in both the United States and Latin America continues to be somewhat divided on the virtues of a hemispheric trade bloc. U.S. labour unions and anti-globalization activists have argued that an FTAA would lead to the export of jobs by producing an outflow of U.S. capital in pursuit of the much lower wages and weaker safety and environmental standards that exist throughout Latin America. There is also concern that U.S.

participation in an FTAA would mean more involvement (e.g., foreign aid, financial bailouts) in the instabilities and economic turmoil of many of its southern neighbours.

In Latin America, public opinion is focused on entirely different issues: the lack of adequate education on, and information about, free trade and the FTAA; and the desire for free trade to address the development needs of individual countries and reduce income inequality among citizens. On the former point, educating the public about the benefits of free trade could help mobilize the broad-based support required for trade liberalization initiatives. Right now, there is much concern within the Americas about how a hemispheric free trade agreement would open domestic economies to increased competition and to scrutiny of workers' rights and environmental standards.(11)

Regarding concerns about the link between trade and development, public opposition to hemispheric free trade could grow even further if the region's poverty levels and income inequality do not decline. Income inequality continues to be a major problem in the Americas, and there are expectations that free trade would translate directly into improved living standards for all. However, solutions in this area are not likely to flow directly out of a trade agreement. Rather, the process is more indirect: national governments would be in the best position to use the benefits from free trade to actively address their income inequality concerns.

5. The Difficulty of Reaching Agreement Between 34 Different Nations

On the surface, the technical aspects of dealing with a host of complex issues among 34 countries of vastly different size, sophistication and economic power, and virtually all linked one way or another by a maze of sub-regional arrangements, would appear to represent an insurmountable challenge. However, the reality is that the FTAA negotiations are actually occurring between five major groups and a small number of individual countries (NAFTA, Mercosur, the Andean Community, CARICOM, the Central American Common Market, Chile, the Dominican Republic and Panama).

Another positive sign is that the North-South divide that some feared would materialize in the negotiations has not. Where alliances have formed, they have usually done so with respect to certain negotiating issues.

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(11) "Free trade in the Americas: Stumbling blocks to trade blocs," *Strategic Comments*, Volume 7, Issue 4, International Institute for Strategic Studies, May 2001, p. 2.

Certainly, much of the success of the FTAA will depend on the individual negotiating groups. Largely through the regional groupings identified above, all countries have been involved in the negotiations, and all have invested considerable time. Whether the FTAA process ultimately proves successful will, of course, come down to the important trade-offs that countries will be asked to make.

6. The Launch of a New WTO Round

With the launch of a new WTO round at Doha in November 2001, which option (FTAA or WTO) will attract priority among the countries of the Western Hemisphere? Which of the two promises the opportunity to achieve more in terms of greater trade liberalization, greater security of market access, the elimination of trade and investment subsidies, and non-discriminatory treatment of investment?

The fear among those involved in the negotiations is that with both sets of negotiations having the same deadline (2005) and encompassing similar broad negotiating topics, the discussions at the multilateral level could make countries reluctant to conduct substantial FTAA negotiations until the shape of WTO negotiations becomes clear. Countries such as Brazil and the United States, for example, might wait to see if they can get a better deal at the WTO.

Although there are indications that the Doha launch has had little impact on the FTAA negotiations, there may be some substance to the above-mentioned fear. For example, a number of potential FTAA participating countries have already indicated that they would prefer to have market access issues for agricultural products dealt with in the ambit of the WTO negotiations. While FTAA negotiations could make valuable progress on access for most processed agricultural products, it is likely that real progress on the critical question of export subsidies and domestic support would have to await the conclusion of the WTO negotiations.

What this suggests is that, ultimately, key trade liberalization issues should be addressed at both venues. On many issues, the FTAA will have to be “WTO plus” for any advantages to accrue from entering into a regional trade agreement. On other issues, such as those in the highly sensitive agricultural area, a successful deal at the broader WTO level may be required.

C. Key Negotiating Issues

When FTAA negotiations were initiated in 1998, nine negotiating groups were formed. These include: market access; agriculture; investment; services; dispute settlement; subsidies, anti-dumping and countervailing duties; government procurement; intellectual property rights; and competition policy. A different country chairs each group, with the FTAA negotiating process coordinated by the overarching Trade Negotiations Committee. An additional four groups were established to address a number of horizontal issues: smaller economies; civil society; electronic commerce; and technical and institutional issues.

Canada has already made public its positions on the above areas.(12) What follows is a brief discussion of some of the more contentious issues involved in the negotiations.

1. Market Access

Critical market access issues that form the core of the FTAA negotiations are now being discussed. An FTAA would address both tariff and non-tariff barriers (e.g., technical standards, sanitary and phytosanitary measures), as well as other issues such as rules of origin and technical barriers to trade. For its part, Canada seeks to eliminate tariffs on all products, with limited exceptions phased out over a transition period.

Much of the success of the overall negotiations will depend on a successful resolution of market access issues. Specifically, the United States and Brazil continue to differ on exactly how tariffs and other measures restraining access should be removed. The United States has already lowered its average tariff rates substantially, but continues to face high Latin American tariffs on its automobiles and other key products. It is, therefore, placing considerable emphasis on tariff reduction.

Brazil, on the other hand, possesses the second-highest average tariff rate among negotiating countries and is wary of sizeable reductions, fearing a rush of U.S. imports. It is placing its negotiating priority on improving access to the U.S. market for its agricultural, steel, textile and clothing exports, and is demanding reductions in the use of trade remedies (anti-dumping and countervail duties) and in peak tariff rates. However, the United States would prefer to negotiate on the trade remedies question at the WTO.(13)

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(12) These positions can be found at: http://www.dfait-maeci.gc.ca/tna-nac/ftaa_new_archives-e.asp.

(13) Hornbeck (2002), p. 4.

To place pressure on Brazil to offer up meaningful market access concessions, the Unites States has resorted to a negotiating strategy of providing different tariff reduction rates to different countries in the FTAA negotiations, based on their level of development. This approach would involve maintaining existing preferential trade agreements during a tariff phase-out period of 10 years or more. Brazil opposes this approach, fearing that it will be one of the last countries to gain preferential access to the U.S. market. Instead, it would prefer that countries phase down tariffs at the same rate for all countries, with only small Caribbean economies granted quicker reductions for key exports.

When it comes to market access, there is likely no more sensitive issue than agriculture. Many observers have argued for an opening up of agricultural markets in the Americas. One of the key questions, as this paper has already noted, concerns which set of negotiations (i.e., FTAA or WTO) will permit the most progress in agricultural trade liberalization. Some countries stress the importance of addressing market access issues in agriculture during the FTAA negotiations; others see the WTO as the most appropriate forum for a comprehensive set of agricultural negotiations involving the European Union. In the end, most would agree that many of the agricultural issues will require resolution at the multilateral level.

2. Concerns of Small Economies

Smaller economies represent three-quarters (26 out of 34) of the FTAA negotiating countries. Thus, it is not surprising that the integration of these smaller economies' concerns into the negotiating process has been an important preoccupation. The FTAA has to overcome certain obstacles such as the different levels of income in Latin American countries, and mechanisms that recognize the different development needs of poorer countries need to be established.

It should be noted that many developing countries are wary about entering into an agreement that could overwhelm their fragile economies. One of the key issues is how these countries can best develop their own taxation systems as a replacement for tariffs. In many cases, the shift from a tariff-based economy to the development of an income tax system poses a difficult challenge.

The introduction of longer phase-out times for tariffs has been viewed as an important option for offering special treatment of small economies. While Canada continues to believe that all FTAA signatories must assume the same rights and obligations, it does support the inclusion of measures in the agreement to ease the transition of smaller economies, provided that such measures are specific and time-limited. Indeed, FTAA negotiators reached agreement (in September 2001) on guidelines for considering, on a case-by-case basis, special treatment based on differences in levels of development or size of economies. These guidelines would be used by individual FTAA negotiating groups to evaluate proposals from individual countries requesting special treatment.

It is also critically important to help these countries' trade policy capacity-building efforts, so that they can implement the domestic policy and legal reforms required to conform to FTAA rules and train their trade negotiators properly. Many of the small countries that comprise the majority of states in the Americas lack the technical expertise to implement a trade deal. Several countries could, therefore, find it difficult to implement the treaty without some form of assistance. Capacity building helps society reap the benefits of more open markets resulting from trade liberalization. It could also help generate the resources that smaller countries require to undertake FTAA negotiations more effectively themselves.

Canada has historically been responsive to the interests of smaller economies. Through the Canadian International Development Agency, Canada is helping smaller economies to participate in the FTAA process and in bilateral trade negotiations with Canada by providing technical assistance programming designed to build capacity for trade, investment and financial stability. In April 2001, Canada announced new funding of $18 million in trade-related technical assistance to Caribbean and Central American countries, which together account for the vast majority of the smaller economies of the Americas. Of this total, $13 million is destined for the Eastern Caribbean Economic Management Program and up to $5 million for projects in Central America.

Canada is also supporting the efforts of the Inter-American Development Bank (IDB) and the World Bank in assisting future FTAA members to become more successfully integrated in the global economy. Over the next four to five years, the IDB plans to allocate between $40 and $45 billion in funding to the Latin American and Caribbean region. This financing would be available to address countries' economic and social concerns, whether FTAA-related or not.

3. Investment

The insertion of an investment agreement within the FTAA, to consolidate the various commitments in existing sub-regional and bilateral agreements and to extend coverage to countries not bound by international agreements, would serve the interests of investors. Many countries in the Americas would benefit from a hemispheric, rules-based, secure and predictable environment for investors.

The only significant source of controversy here is the possible use of provisions – referred to as "investor-state provisions" – modelled on those found in Chapter 11 (the Investment chapter) of NAFTA. Such provisions would allow private-sector investors to seek damages through an international tribunal for government actions that constitute a taking of investors' property or that violate minimum standards of treatment. Concerns have been expressed about the use of such provisions in trade agreements and their effects on nations' sovereignty, particularly in terms of governments' regulatory powers and the provision of public services.

International Trade Minister Pierre Pettigrew has indicated that the investor-state provisions contained in Chapter 11 need to be clarified in order to limit their application, and that greater transparency in their use is required. Indeed, the Government of Canada is seeking such clarification with its NAFTA partners. In the negotiation of future trade agreements such as the FTAA, Canada will likely be guided by past experience with the negotiation and implementation of investment rules with other countries, including the existing litigation under NAFTA's Chapter 11.

4. Labour and Environment Standards

The question of how to address labour and environmental standards in the context of the FTAA needs to be resolved. Developing-country leaders are not opposed to cooperating on a labour and environment agenda that complements trade negotiations, but they are reluctant to link these issues directly to the trade agreement for fear of restraining trade and investment, and thus economic growth. Linking the enforcement of international labour standards to trade agreements is perceived by developing countries as back-door protectionism and is therefore resisted.

On the other hand, some would argue that differing standards among FTAA countries could provide competitive advantages in both trade and investment.(14) Certain labour and environmental interest groups advocate incorporating international environmental and labour standards directly into trade agreements, so that they too would be enforceable.

Two key issues stand out in the negotiations: where to place the labour and environment provisions in the agreement, and whether to use trade sanctions as a possible remedy in cases of violations of the provisions. On the second, more critical issue, most FTAA negotiating countries do not favour the use of trade sanctions.

5. Transparency and Civil Society Participation

The Government of Canada takes the issue of transparency seriously, and considers itself the "champion" in this area. In February 2001, Canada put forward proposals to the FTAA parties to strengthen the rather limited civil-society participation in the FTAA. These proposals include: issuing regular updates; hosting regular public meetings throughout the hemisphere on FTAA negotiating issues; making FTAA documentation available where possible; and forwarding civil-society submissions to relevant groups, committees and institutions.

Arguably the most effective step in eliminating the claim that trade negotiations are shrouded in secrecy, and that only the interests of major international firms are taken into account, was the decision to make the FTAA negotiating text public. Its release was viewed by the Canadian government as a radical move toward greater transparency in trade negotiations. An effort has also been made to expand the trade agenda to include more issues, thereby taking into account public concerns.

(14) Hornbeck (2002), p. 4.