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Western Hemisphere Trade Developments

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Summary

The countries of the Western Hemisphere constitute the largest regional market for U.S. exports and the second largest regional market for U.S. foreign direct investments. The growing importance of this region to U.S. economic interests has been complemented by the growth of sub-regional integration initiatives such as the North American Free Trade Agreement (NAFTA), Mercosur, the Andean Community, the Central American Common Market, and Caribbean Community. These groupings have not only established free trade areas and in some cases customs unions among partner countries, but are also expanding trade and investment ties with other countries and regions in the hemisphere, as well as more tentatively with the European Union. Concurrent with the deepening and expansion of these sub-regional groupings have been efforts to create a Free Trade Area of the Americas (FTAA). While FTAA negotiations formally commenced in September 1998, the deadline for completion is not until 2005. If the FTAA negotiations were to lose momentum, hemispheric integration could come to be dominated by the proliferation of sub-regional groupings. This development, in turn, could have varying impacts on U.S. interests.

The Western Hemisphere Market

The Western Hemisphere is the largest regional market for U.S. exports. In 2001, the region purchased U.S. goods valued at \$324 billion, a sum that accounted for 45% of total U.S. exports. By contrast, the countries of the Pacific Rim (including Japan) purchased \$182 billion or 25% of U.S. exports, and the countries of Western Europe bought \$175 billion or 24% of U.S. exports.¹

U.S. exports to Canada and Mexico, its North American trade partners, totaled \$265 billion in 2001, accounting for 82% of the region's total or 37% of U.S. exports to the world. Thirty-one countries of the Caribbean, South and Central America purchased \$58

¹ The data used in this report are from the U.S. Department of Commerce, the World Bank, the Office of the U.S. Trade Representative, and the Inter-American Development Bank.

billion of U.S. exports, equaling 18% of the region's total or 8% of U.S. exports to the world. Of these thirty-one countries, three – Argentina, Brazil and Venezuela – accounted for \$25.5 billion or 43% of the group's total. Argentina and Venezuela combined to buy more U.S. products (\$9.6 billion) than Eastern Europe (\$6.9 billion) and Brazil bought more (\$15.9 billion) from the U.S. than Italy and Spain combined (\$15.2 billion).²

On the import side, the United States remains the most important market for the majority of countries in the Western Hemisphere. Canada and Mexico are the two countries most heavily dependent on the U.S. market. In recent years, both have shipped over 75% of their exports to the United States. These shipments, in turn, accounted for 30% of total U.S. imports and 84% of all U.S. imports from the Western Hemisphere. Most of the Caribbean and Central American countries also tend to be quite dependent on the U.S. market, sending anywhere from one-fourth to one-half of their total exports to the U.S. The larger countries of South America, particularly Brazil, Argentina, and Chile, are less dependent on the U.S. market; historically, the U.S. market has accounted for only about 20% of their total exports.

U.S. economic ties with the Western Hemisphere are also strengthened through a large stock of foreign direct investment. In 2000, the countries of the Western Hemisphere were host to \$366 billion or 29% of total U.S. foreign direct investment worldwide. By contrast, Europe accounted for 52% and the Pacific Rim countries 16% of the total stock of U.S. foreign direct investment.

The strong U.S. commercial position in the Western Hemisphere has been spurred by far-reaching market-oriented economic reforms and unilateral reductions in trade and investment barriers undertaken by most all the countries in the region during the 1990s. Most notably, the average tariff applied by Latin American and Caribbean countries has dropped from around 35% in the late 1980s to around 12% today.

The liberalizing trend has been complemented by the evolution of sub-regional groupings that have deepened economic and political ties among partner countries. These groups not only have established free trade areas, but in some cases have evolved into customs unions. Some of the groups have negotiated preferential trade agreements with other countries in the hemisphere, and some are bolstering their trade and investment ties with the European Union. In the process, the region has become much more open to trade, and trade, in turn, has become a more important engine of economic growth.

Sub-regional Groupings

Five sub-regional groups have made considerable progress over the past decade in reducing barriers to trade and investment. These include the North American Free Trade Agreement (NAFTA), the Common Market of the South (MERCOSUR), the Andean Group, the Caribbean Community and Common Market (CARICOM) and the Central American Common Market (CACM).

² For further discussion of U.S. trade with Latin America, see CRS Report 98-840, *U.S.-Latin American Trade: Recent Trends*, by J.F. Hornbeck.

Nafta. NAFTA, which became effective on January 1, 1994, is the largest preferential trade agreement in the world. This agreement, which eliminates tariffs and other trade and investment barriers among Canada, Mexico, and the United States over a 15-year period, applies to a market that encompasses over 414 million people and that produces over \$11 trillion in goods and services.

The first 8 years of NAFTA's operation (1994-2001) have seen substantial increases in intra-regional trade and investment flows. Labor, environmental, and market access problems illuminated by increased economic integration have been addressed by a variety of institutional arrangements and fora.

Total U.S. trade with its NAFTA partners has increased significantly over the past 8 years. In 2001, Canada and Mexico accounted for \$613 billion or 33% of U.S. total trade of \$1.87 trillion, up from \$292.7 billion or 28% of U.S. total trade in 1993. The U.S. trade deficit with its NAFTA partners has also grown, rising from \$12 billion (9 % of the total) in 1993 to \$112 billion (27% of the total) in 2001.

Mexico and Canada have increased their importance in absolute terms as a site for U.S. direct investment. In 2000 (the most recent data), the two accounted for \$162 billion or 13% of total U.S. foreign direct investment (FDI). This compares to \$85 billion or 15% of total U.S. foreign direct investment in 1993. Canadian FDI has gone from \$70.4 billion or 12.8% of total FDI to \$126.4 or 10% of total FDI and Mexico from \$15. 4 billion or 2.8% to \$35.4 or 2.8% of total U.S. FDI.

The sharp increase in North American trade and investment flows has been accompanied by some disputes. Prominent U.S.-Canadian disputes have involved trade in softwood lumber, wheat, and dairy products. Prominent U.S.-Mexican disputes have involved Mexican access to the U.S. trucking market and sugar market and U.S. access to the Mexican high-fructose corn syrup (a sweetener) market. With regard to investment, the investor-state provisions in NAFTA's Chapter 11, aimed at protecting investors from expropriation measures, have been actively used.

While the NAFTA agreement allows for the accession of other countries, to date no country has applied for NAFTA membership. But individual NAFTA members have negotiated or are negotiating trade agreements with other countries that are patterned substantially after NAFTA provisions and obligations. Mexico has been the most active, having negotiated trade agreements with Bolivia, Chile, Costa Rica, the Group of Three (Colombia, Mexico, and Venezuela), Nicaragua, and the Northern Triangle countries. Canada has concluded trade agreements with Chile and Costa Rica and the United States is negotiating a trade agreement with Chile.

Mercosur. MERCOSUR or the Southern Common Market was created in 1991 by the Treaty of Asuncion. Consisting of Argentina, Brazil, Paraguay, and Uruguay, MERCOSUR is the second largest preferential trade group in the Western Hemisphere, with a combined gross domestic product of \$900 billion (representing half of Latin America's GDP) and a population of 215 million in 2000. Chile and Bolivia are associate members of the group.

In the process of developing closer economic ties, these countries have eliminated tariffs on a substantial portion of intra-MERCOSUR trade and have instituted a common

external tariff (CET) covering the majority of products imported from non-member countries. Intra-MERCOSUR trade in sensitive products such as automobiles and steel remains subject to tariffs or special arrangements. Moving beyond an internal free trade area and customs union to a common market, where restrictions on the movement of labor and capital are eliminated, is the group's ultimate aim.

Throughout much of the 1990s, MERCOSUR was the most dynamic economic subgroup in the Western Hemisphere in terms of trade growth among its members. In the wake of Brazil's 1999 devaluation and Argentina's recent economic turmoil, momentum towards deeper integration has been slowed.

In 2001, the U.S. trade surplus with MERCOSUR was \$2.9 billion, a decrease of \$600 million from the U.S. trade surplus of \$3.7 billion in 2000. U.S. goods exports to MERCOSUR were \$20.6 billion in 2001 and U.S. goods imports were \$17.7 billion. The U.S. direct investment position in MERCOSUR totaled \$50.5 billion.

MERCOSUR countries have been negotiating free trade agreements with the Andean Community and with the European Union (EU) in recent years. In September 2001, the United States and MERCOSUR countries resumed meeting under the framework known as the Four Plus One. At the September meeting, the two sides agreed on a work plan to deepen their trade relationship.³

Andean Community. The Andean Community is one of the oldest sub-regional groupings in the hemisphere. The group, which was originally formed in 1969 as the Andean Pact (and later called the Andean Group), consists of Bolivia, Colombia, Ecuador, Peru, and Venezuela. Based on a combined GDP of \$279 billion and a population of 113 million in 2000, the Andean Community currently is the third largest preferential trade group in the Western Hemisphere.

The Community established a four-country free trade area in 1993 and a partial customs union between three members (Colombia, Ecuador and Venezuela) in 1995. Although Peru did not initially sign these agreements, it did negotiate bilateral trade accords with the other members of the group, and in 1997 agreed to fully integrate into the free trade area by 2005. As a result of the free trade area, the five members of the community have become not only more integrated among themselves, but also with the rest of the hemisphere.⁴

In 1999, the Andean presidents pledged to transform the Andean Community into a common market by 2005 whereby not only goods and services, but also capital and labor, would move freely. Efforts to create a more integrated Andean economic union, however, have been complicated by a number of recent economic and political setbacks in the region.

³ Office of the U.S. Trade Representative. *2002 Trade Policy Agenda and 2001 Annual Report*, p. 117.

⁴ Salazar-Xirinachs, Jose M. and Maryse Robert, eds., *Towards Free Trade in the Americas*, Brookings Institution, 2001, p.16.

The Community has a substantial institutional structure patterned along the lines of the European Community. Its institutions include a formal Andean Presidential Council that meets regularly, a Court of Justice with supranational powers, and an Andean Integration System that incorporates all the Andean integration agencies.

In terms of external trade partners, the group has explored the negotiation of free trade agreements with MERCOSUR, the Northern Triangle (El Salvador, Guatemala, and Honduras) and Panama. In the FTAA negotiations, the countries participate with a single voice.

The main trade issue between the United States and the region currently involves the Andean Trade Preference Act. This act, which provides reduced-duty or duty-free treatment to most imports from Bolivia, Colombia, Ecuador, and Peru, expired on December 4, 2001. The Andean countries have strongly supported expansion and renewal of the program. The European Union provides its own system of Andean Preferences.

Cacm. The Central American Common Market (Cacm) was created in 1960 and consists of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. Panama, which has observer status, and Belize participate in CACM summits, but not in the regional economic integration scheme. The CACM countries in 2000 had a combined GDP in excess of \$56 billion, and an internal market of over 39 million people.

The CACM has succeeded in eliminating duties on most products traded among its members. In 1993, the CACM members committed to achieving a common external tariff with a floor of 5% and a ceiling of 20%, with almost no exceptions. The CET is applied to most products of non-CACM origin. Unilateral liberalization of capital markets by all CACM member countries has facilitated intra-regional financial flows, including significant levels of intra-regional foreign direct investment.

The CACM members have maintained a flexible position in their external trade negotiations, operating as a group in some negotiations and individually on others. CACM as a group negotiated a comprehensive free trade agreement with the Dominican Republic in 1999. Costa Rica and El Salvador have both negotiated free trade agreements with Mexico, as have the countries of the Northern Triangle (El Salvador, Guatemala, and Honduras). Additional efforts at trade integration have included the conclusion of separate free trade accords by Costa Rica and Canada in 2001. Negotiations between other CACM countries and Canada began in late 2001.

During 2001, the CACM countries expressed an interest in pursuing free trade negotiations with the United States. In January 2002, President Bush announced his administration's interest in exploring a free trade agreement with the CACM countries. Currently, the scope and timing of the negotiations are under discussion.

Caricom. The Caribbean Community (CARICOM) was established in 1973, and consists of 15 independent countries: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Haiti, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago. Despite its large membership, CARICOM is the smallest regional integration scheme in the hemisphere: the group's combined GDP in 2000 was less than \$20 billion and its population (excluding Haiti) of 6 million. Perhaps due to its small size, CARICOM members

historically have been strong supporters of regional integration schemes and joint development projects.

Major accomplishments of Caricom during the 1990s include substantial completion of a free trade area in goods, as well as uneven country implementation of a common external tariff composed of six rates ranging from 0% to 40%. Progress has also been made on liberalizing movement of labor and capital with a view towards achieving a Caricom Single Market and Economy (CSME).

At the same time, the Community has continued to broaden its trade relationships with neighboring countries, particularly Venezuela, Colombia, the Dominican Republic, and Cuba. Outside the hemisphere, Caricom members are among the 77 countries provided trade preferences under the European Union's African, Caribbean, and Pacific (ACP) framework.

In recent years, the United States has experienced a trade surplus with Caricom countries, ranging from \$1.6 billion in 1999 to \$1.1 billion in 2001. Caricom countries hope to be able to increase their exports to the United States as a result of implementation of the U.S.-Caribbean Basin Trade Partnership Act. Enacted on May 18, 2000, the CBTPA is a program of unilateral trade preferences that intends to provide Caribbean countries with the same level of tariff preferences that Mexico enjoys under NAFTA.

Prospects for Hemispheric Free Trade

At the Summit of the Americas held in December 1994, the hemisphere's 34 democratically elected governments committed to the goal of creating a "free trade area of the Americas" (FTAA) by the year 2005. The agreement would eliminate barriers to trade in goods and services and to investment, and provide strong rules or disciplines in such areas as intellectual property protection, subsidies, government procurement, and competition policy.⁵

In the six and one-half years since the Miami Summit, negotiators have made substantial progress, but serious political and economic obstacles remain. Slowing economic activity throughout the region, lukewarm political support in Brazil and the United States, on-going economic or political turmoil in countries such as Argentina, Colombia, and Venezuela, and efforts to launch a new round of multilateral negotiations are major challenges that will have to be overcome if the FTAA is to come to fruition.

If efforts to create the FTAA are derailed for whatever reason, it can be expected that the other countries of the Western Hemisphere will continue to expand their own regional trade groupings and will continue to look for new integration partners — both inside and outside the region. The impact such a development will have on U.S. exports and investments remains uncertain.

⁵ For further discussion, see CRS Issue Brief IB95017, *Trade and the Americas*, by Raymond J. Ahearn; and CRS Report RS20864, *A Free Trade Area of the Americas: Status of Negotiations and Major Policy Issues*, by J.F. Hornbeck.