. . . as appeared in . . .

Published by *WorldTrade Executive, Inc.*

LATIN AMERICAN
Law & Business Report

Volume 16, Number 9

September 30, 2008

Free Trade Alternatives in the Western Hemisphere for a New Administration

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Reversing the Loss of U.S. Influence in Latin America and the Caribbean

Regardless of who emerges victorious in the United States Presidential election on November 4, 2008, the new administration will have a major task to rebuild U.S. leadership in the Western Hemisphere. Recent polls show that a majority of Latin Americans view the United States unfavorably.[1] This is coupled with a widespread perception in Latin America and the Caribbean shared by people from across the political spectrum that the U.S. has ignored the region since the September 11, 2001 Al Qaeda attacks in the northeastern United States. For example, initiatives to manage the flow of immigrants into the U.S. from Latin America and the Caribbean were put on the back burner. The ambitious Clinton administration project to create a Free Trade Area of the Americas (FTAA) that elicited so much enthusiasm among hemispheric governments became moribund. The void created by the absence of any visionary or proactive policies emanating from Washington, D.C. has been filled by Venezuelan President Hugo Chavez's attacks on market oriented economics coupled with generous cash transfers to reduce foreign debt obligations and fund social programs that assist the poor. In the Caribbean, Chavez has successfully convinced many governments to shift their petroleum imports away from Trinidad and Tobago to Venezuela. In many Latin American countries, politicians have adopted Chavez's rhetoric to win power and begun chipping away at the trade liberalization and privatization reforms of the 1990's. Even more ominous for the future growth of U.S. exports of goods and services to Latin America and the Caribbean is the fact that many countries in the region are prioritizing trade relations with Asia. In addition, the European Union is better poised than the U.S. to complete a free trade agreement with important markets in South America than the United States.

To stem if not reverse the serious loss of political influence and economic advantages historically enjoyed by the U.S. in Latin America and the Caribbean, the new administration will have to immediately put forward an ambitious policy that excites the imagination of the bulk of the region's population. One initiative that will certainly engage the region is the construction of a Community of the Americas. This initiative contemplates not only the establishment of a hemispheric free trade area but should also include provisions on regulated, cross border migration and offer European Union style funding to improve infrastructure and human resource capabilities. Such an initiative gets around the fact that the FTAA has become anathema to many in Latin America and the Caribbean and is rejected by important constituencies in the United States. A Community of the Americas also takes the steam out of Chavez's strong opposition to the FTAA and his promotion of a Bolivarian Alternative for the Americas (ALBA) that is based on "the principles of solidarity, genuine development, and respect for the dignity of the human person".

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Bringing MERCOSUR and CARICOM on Board

Undoubtedly the biggest challenge to establishing a Western Hemisphere free trade area, even within the context of a Community of the Americas, will be to get

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the MERCOSUR countries on board, particularly Brazil. Even without any type of preferential market access agreement, Brazil is among the top 15 destinations for U.S. exports. The U.S. is also the largest single foreign investor in Brazil, representing almost a quarter of foreign direct investment in that country. With some 190 million people and a growing and stable economy, Brazil is the Latin American country that provides the best opportunities for future growth of U.S. exports of goods and services. At the same time, the U.S. is Brazil's most important trading partner, with a significant percentage of Brazilian exports made up of non-traditional manufactured products such as airplanes, motor vehicles, and auto-parts. The heightened importance given to bio-fuels in the U.S. as a way of reducing greenhouse emissions and dependence on unreliable foreign petroleum suppliers, will undoubtedly raise Brazil's prominence as a supplier of both advanced sugar based ethanol technology and resources. Accordingly, there is a growing symbiotic relationship between Brazil and the U.S. that augurs well for some type of free trade arrangement that includes both countries.

In the past, Brazil was often perceived by some in the U.S. government as a key impediment to the creation of an FTAA. The reality, however, is that Brazil sought to obtain two key concessions from the U.S. in the FTAA that had previously eluded it in the multilateral context. One goal involved reducing and eventually eliminating domestic agricultural support payments and subsidized agricultural exports as well as restricting the use of tariff peaks. A second goal was to eliminate the application of anti-dumping duties. The U.S. insistence that both issues could only be negotiated at the World Trade Organization contributed to the stagnation of the FTAA process and focused Brazilian attention on obtaining concessions in the multilateral arena. With the latest collapse of the Doha Round talks, however, Brazil may now have no option but to negotiate some type of preferential market access agreement with North America.

Unable to obtain the concessions it sought from the developed world at the WTO, Brazil will not sabotage a free trade agreement with the U.S. by insisting that it receive substantial concessions on agricultural subsidies and anti-dumping. Although Brazil often appears as the chief proponent for eliminating agricultural subsidies at both the multilateral and hemispheric level, the reality is that this issue is more of an imperative for its MERCOSUR partner, Argentina, which has had little but agricultural commodities to offer the international market on a genuinely competitive basis. Up to now, Brasilia has spearheaded the issue because it is also in its interest and it provides a way of preserving MERCOSUR unity. However, the Lula administration has repeatedly shown itself to be pragmatic. It will not let agricultural subsidies sacrifice an agreement that allows Brazil to expand non-traditional, manufactured exports to the U.S. market and obtain new inflows of foreign direct investment. This is particularly true if the U.S. follows through on past promises to curtail its use of agricultural export subsidy programs to Western Hemisphere destinations as part of an FTAA. In addition, the importance of eliminating agricultural subsidies has diminished as a result of the recent explosion in Chinese and Indian demand for Latin American agricultural exports. Even the anti-dumping issue has been defused in recent years as those Brazilian industries that historically were most negatively affected by U.S. anti-dumping and countervailing tariffs have acquired U.S. subsidiaries. Accordingly, Brasilia will likely settle on the antidumping issue for a procedure similar to one that currently exists in the MERCOSUR that requires government level consultations before an anti-dumping investigation is initiated.

MERCOSUR unity would be enhanced by a Brazilian decision to negotiate as part of the bloc a free trade agreement with the U.S., given that Paraguay and Uruguay strongly support such an accord. The embattled regime of Cristina Fernandez de Kirchner in Argentina will have no other choice but to follow its MERCOSUR partners. For one thing, the huge growth in Argentine agricultural exports to Asia has defused the subsidies issue for Buenos Aires just as it has for Brasilia. Secondly, the sharp devaluation of the Argentine peso in 2002 made certain service providers based in Argentina more competitive internationally and they are likely to serve as an important new constituency group advocating a free trade agreement with the United States.

The bigger CARICOM states would be amenable to a bilateral free trade agreement that makes apparel access permanent and includes cross border movement of service providers.

Although less significant for the U.S. economy than the MERCOSUR, CARICOM is nonetheless politically important because of the large number of votes it represents in multilateral and regional institutions such as the United Nations and the Organization of American States.[2] Unlike the MERCOSUR, CARICOM countries already enjoy special, duty-free market access into the U.S. market for a wide range of products under the Caribbean Basin Economic Recovery Act (CBERA) and Caribbean Basin Trade Partnership Act (CBTPA). In the case of CBERA, eligible products enjoy duty-free treatment indefinitely, while eligible textile and apparel items under CBTPA do so until September 30, 2010.

Despite already enjoying duty-free access to the U.S. market, the bigger CARICOM states would be amenable to a bilateral free trade agreement that makes apparel access permanent and includes cross border movement of service providers. Many Caribbean nations have an excess

of professionals and skilled workers that they would like to temporarily "export" to Canada and the U.S. in order to ensure a steady return flow of remittances. Liberalization of the services sector may also enhance the ability of Caribbean countries to attract foreign direct investment so as to offer locally based educational and medical services, for example, on an internationally competitive scale.

Up to now, the six mini-states of the Organization of Eastern Caribbean (i.e., Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines) have expressed opposition to any type of free trade agreement with the United States. In view of the fact that these six countries have a combined population of less than 600,000, it is conceivable that their governments (along with the Bahamas) could be persuaded to change their minds if they were provided with objective, economic impact analysis studies of how such an agreement would benefit their respective economies. One very important incentive for these countries to participate in a hemispheric free trade area is supplying sugar-based ethanol. Historically, the Eastern Caribbean's only export of any significance was sugar, but this industry entered a long period of decline some 30 years ago with the massive expansion of lower cost sugar production in Brazil. A dramatic increase in global demand for sugar and sugar-based ethanol would revive the profitably of sugar production on small islands with little other alternatives for competitive exports. Another practical way to deal with the potential obstructionism of the OECS or the Bahamas would be to simply exempt them from compliance with certain obligations otherwise incumbent on the bigger Caribbean states.

A Map for Constructing a Community of the Americas

A politically and financially expedient way to build the Community of the Americas would be for the United States to negotiate bilateral free trade agreements with those blocs of countries that remain outside its current web of accords, namely CARICOM and MERCOSUR.[3] In this regard, the U.S.-Central America and Dominican Republic free trade agreement or CAFTA-DR provides an ideal model, as it not only created obligations and disciplines between the U.S. and the other signatory states, but also among them. In particular, new obligations with respect to intellectual property, foreign investment, and trade in services were created that did not previously exist within the Central American Integration System (SICA) or in the free trade agreements the Central American states had with the Dominican Republic. In doing so, CAFTA-DR complemented and helped to deepen what was already occurring at the sub-regional level. By contrast, the bilateral agreements the U.S. negotiated individually with Colombia and Peru undermine the Andean economic integration process by, among other things, perforating its Common External Tariff system. It was precisely this issue that led to the withdrawal of Venezuela from the Andean Community in 2006.

Once the bilateral free trade agreements are concluded with sub-regional blocs, a de facto FTAA could be fashioned by activating the Most Favored Nation (MFN) clauses that exist in each and harmonizing the rules and disciplines among the different trade accords. This is crucial in the area of rules of origin, for example, in order to avoid imposing unnecessary costs on business by requiring different lines of production depending upon the country of export. One thing that will facilitate harmonization is the fact that Canada, Chile, and Mexico have already negotiated their own bilateral free trade agreements with many hemispheric countries that contain key provisions resembling the NAFTA template. In addition, many of the sub-regional integration projects such as the Andean Community, CARICOM, and MERCOSUR have, since the launch of the FTAA negotiations, adopted common disciplines on trade in services and government procurement that did not exist a decade ago. Accordingly, much of the groundwork for carrying out the harmonization process that will eventually result in a de facto FTAA is already in place.

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Energy Security as a Pillar of the Community of the Americas

Making energy security a key pillar of the Community of the Americas, especially one that facilitates the flow of alternative energy resources, is a sure way to garner wide spread support for the project in the United States and neutralize opposition from the environmental lobby. It also provides a way of enticing Venezuela, with its huge reserves of fossil fuels and dependence on petroleum exports, to join in the process.

An integrated Western Hemisphere energy market provides the United States the opportunity to dismantle its ruinous corn based ethanol program that will cost US taxpayers an estimated US$ 9.2 to 11 billion in 2008 in subsidy programs.[4] Ironically, the corn ethanol industry produces almost as much harmful carbon emissions then its inclusion as an additive to fuel was intended to reduce.[5] It has also contributed to a jump in global food prices and led to riots in Haiti and Mexico, as well crowded out soybean production in the United States and pushed more of it to Brazil.[6] This phenomenon, in turn,

has led to more grazing land in Brazil being given over to soybean production, pushing cattle ranchers deeper into the Brazilian Amazon and resulting in further deforestation and a depletion of natural means to take carbon out of the atmosphere. Eliminating the complicated mix of subsidies, high tariffs of 2.5 percent ad valorem duty plus a surcharge of 14.7 cents per liter, and restrictive volume caps that currently protect the inefficient US corn-based ethanol industry, will give US consumers access to less costly and more efficiently produced sugar-based ethanol from Brazil. A liter of Brazilian ethanol made from sugar cane currently costs almost half the "real" cost to produce a liter of corn-based ethanol. In addition, corn-based ethanol yields about the same amount of energy as the fossil fuel needed to produce it. By contrast, in the case of sugar, the input-to-output ratio is about one to eight. Central America and the Caribbean also have the potential to competitively produce sugar-based ethanol as well, and Brazil is already engaged in technology transfer projects with many countries in both regions.

An integrated energy market in the Western Hemisphere offers the possibility of a establishing an effective "cap and trade" mechanism for reducing global greenhouse emissions that is less subject to abuse and fraud. Under the current Clean Development Mechanism (CDM) established under the Kyoto Protocol, credits can be issued to a developed country or its companies for financing projects in the developing world (e.g., building a more expensive thermal plant fueled by natural gas or a hydro dam to generate electricity instead of a cheaper coal powered plant) that reduces global greenhouse gas emissions and would not have been constructed but for the funding emanating from the rich country donor. The credits received through the CDM are then used to offset mandated emission reduction targets at home. Research by two Stanford University Law professors in 2008, however, found that a large fraction of the credits generated under the United Nations administered CDM did not, in fact, represents genuine reductions in emissions. Their report found that many reductions funneled through the CDM could have been accomplished at a far lower price through outright grants and/or that the issued credits did not result in a genuine reduction in emissions because they would have been built anyway.[7] Although the United States never ratified the Kyoto Protocol that expires in 2012, both the Democratic and Republican candidates for the US presidency in the November 2008 elections favored participation in a carbon "cap and trade" program that would include a CDM like mechanism. This mechanism could be administered more effectively at the hemispheric level under the framework of a Community of the Americas.

Conclusion

Of all the foreign policy fiascos left by the outgoing Bush administration, repairing the U.S. relationship with Latin America and the Caribbean should be among the easiest for the new occupant of the White House to fix. One reason is that much of the groundwork for a partnership based on trade and investment has already been set and requires completing the network of free trade agreements the United States has with countries in the Western Hemisphere and connecting them by activating their respective MFN clauses. In order for the concept of a Community of the Americas to succeed, however, it cannot rest exclusively on free trade----even genuine free trade (something that has not characterized NAFTA or any of the accords the U.S. currently has with Latin America). There also needs to be a concurrent program intricately linked to the project to improve infrastructure and human capacity skills in order to better ensure that a hemispheric free trade area will lead to equitable economic growth and not favor a small, privileged elite. That is going to require a large financial commitment on part of the richer countries in the Americas. While the U.S. may not be in a position over the short term to provide significant capital infusions as it rebuilds its own devastated financial services sector, there are now South American countries that can, given the huge build up in their reserves generated from export sales to Asia over the past few years.

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1. A compilation of representative survey data is available at: http://www.worldpublicopinion.org A survey conducted among residents of the capital cities of the Southern Cone by the Santiago office of the Latin American think tank FLACSO in September 2005, found that 70% of the respondents viewed the U.S. as an imperialist country that did not contribute to world peace. On the other hand, a majority still admired the dynamism of the U.S. economy.
2. CARICOM member states include Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Saint Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.
3. The U.S. currently has free trade agreements in force with Canada, Chile, the Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Peru. The agreements with Colombia and Panama await ratification by the U.S. Congress. The free trade agreement with Costa Rica has yet to be ratified by the Costa Rican Congress.
4. D.KOPLOW, BIOFUELS-AT WHAT COST?: GOVERNMENT SUPPORT FOR ETHANOL AND BIODIESEL IN THE UNITED STATES 1 (OCTOBER 2007).
5. Carbon emissions for the production of corn-based ethanol are particularly high because the harvesting of corn is heavily mechanized, whereas sugar and other inputs harvested for biodiesel in the developing world are still labor intensive. Corn also requires a larger amount of fertilizer made from petrochemicals and more carbon-generated energy is required to convert cornstarch into a sucrose that can then be fermented into ethyl alcohol. By contrast, sugar requires less energy intensive steps to convert it into ethyl alcohol and the energy expended for this conversion in Brazil is all renewable biomass (i.e., discarded sugar stalks, etc.). Furthermore, the amount of liters of ethanol generated by an acre of land planted with sugar is more than twice the volume generated from an acre planted with corn.
6. See, e.g., J. VON BRAUN, THE WORLD FOOD SITUATION: NEW DRIVING FORCES AND REQUIRED ACTIONS 6-9 (2007). The supply of corn increased 24 percent in the northern

United States during 2007, primarily because of higher corn acreage (the highest since 1933). James, Food Fight, 31 FREE TADE BULLETIN 2 (Jan. 31, 2008). As US farmers have shifted production to meet a surging artificially induced demand for corn-based ethanol, the acreage devoted to soybeans has decreased by 16 percent respectively. Id. at 2. For 2008, preliminary forecasts indicated that one-third of the US corn crop is to be turned into vehicle fuel while the world's poor are reeling from spiraling food prices, including a 78 percent rise in corn prices between August 2007 and May 2008. Johnson, Enthusiasm for Biofuels is Questioned, Fin. Times, May 5, 2008, at 18.

7. See, M. Wara & D.G. Victor, A Realistic Policy on International Carbon Offsets, (April 2008) (Program on Energy and Sustainable Development Working Paper # 74). Available at: http://fsi.stanford.edu/publications/a_realistic_policy_on_international_carbob_offsets/ Another finding is that the CDM has perversely drawn developing countries into engaging in activities that result in greater emissions as a way of generating valuable CDM credits that can be offered to desperate firms from the developed world looking to obtain them for offset purposes.

Reprinted from the September 30, 2008 issue of *Latin American Law & Business Report*

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