

## Is the FTAA at an Impasse? The Key Players US and Brazil

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If everything goes as planned, 34 states in the Western Hemisphere will sign a free trade agreement in less than a year and half. With a 13 trillion dollar economy (40% of the world's GNP) and 820 million potential consumers, the Free Trade Area of the Americas (FTAA) would be the world's largest trading block and an FTA of continental dimensions. Although negotiations are continuing – with the US and Brazil serving as co-chairs since November 2002–, thirteen years after the initial launch of the project, doubt, in the US and Latin America, is growing that a free trade zone stretching from *Tierra del Fuego* to Alaska will ever exist.

Negotiations over a free trade zone of the Americas are entering a crucial phase. All states and country groups have been asked to present their proposals for lowering trade barriers by the time of the next conference of trade ministers in November 2003. The final treaty is to be signed in January 2005 and ratified by December of the same year. According to the schedule, around ten years later a free trade zone in the Western Hemisphere (with the exception of Cuba) would become a reality.

### The Key Players: The US and Brazil

From the perspective of Latin America, the FTAA is more than just a free trade zone. It is not only about trade, but also about redefining relations with the superpower to the north. This is particularly true in Brazil's case, which, as a regional power and the largest country in Latin America, represents the key to the future of the

FTAA. Since most Latin American states either already have NAFTA status, are in negotiations for an FTA or enjoy unilateral trade preferences with the US, the FTAA is above all about bringing Brazil into a continental alliance under US leadership. Brazil is the only «global trader» in Latin America with a strong domestic industry and diversified trade relations.

Under Brazil's leadership, Mercosur has developed into a political, though not an economic, «counterweight» to the US-dominated FTAA project. Hence, politically and economically the FTAA would represent an alliance between the US and Brazil as the leading powers of North and South America. It would combine the two most important economic blocks of the Americas: Mercosur and NAFTA.

The US and Brazil are the key negotiating parties competing in the FTAA process. Agreement between the two is the necessary condition for the creation of the FTAA.

In terms of economic strength, the US is overwhelmingly superior: Brazil accounts for around 7% of the combined GDP of FTAA states whereas the US makes up 75%. Within Latin America, however, Brazil is clearly the most important country. It produces half of the continent's economic output and accounts for half of Latin America's population and territory.

While the US and Brazil are unequal partners on the global stage, the two share a number of characteristics in terms of structural conditions and self-image:

- ▶ Both countries freed themselves early on from their respective colonial leaders, Great Britain and Portugal, and are now far superior to them in terms of economic and international importance.
- ▶ Due to their linguistic and cultural differences with «Latin» America, both the US and Brazil have unique identities which have also traditionally led to them playing a special role within the Americas.
- ▶ Thanks to the size of their domestic markets, foreign trade is not a major economic factor in either country. With exports and imports accounting for barely more than 10% of GNP, Brazil and the US are less dependent on any particular trading partner than Chile, Canada or Mexico, for example, where exports contribute to nearly 40% of GNP.
- ▶ Both the US and Brazil are «global traders» with diversified trade relations. This distinguishes them from almost all other states in the Americas (with the exception of Chile), which can be characterized as «regional traders.»
- ▶ Because of their size, the two countries are bound by their proclivity towards isolation and unilateralism, a tendency to think on a continental scale and a claim to regional and/or global leadership. While the US often distinguishes itself by its military superiority, Brazil is a «soft» regional power that acts in concert with other states.
- ▶ Both have a magnetic effect on the two key processes of integration within the

Americas with the USA acting as the motor of NAFTA and Brazil as the leader of Mercosur.

Although the GDP of the US is ten times greater than that of Brazil, Brazil is the ninth largest economy in the world and therefore an attractive market for the US and the key economic incentive for establishing a continent-wide free trade zone. For Brazilian companies, the opening of the US market promises great opportunity for competitive branches of industry and certain agricultural products. There are, however, fundamental disputes between the two countries that appear to be unsolvable given their different interests. These could end up blocking the FTAA negotiations indefinitely. From the Brazilian point of view, the main sticking points in the negotiations are US special duties on steel imports, the reduction of agricultural subsidies and other non-tariff trade barriers. Brazil is demanding that the US grant clear concessions in all three areas within the FTAA-framework. At the same time, Brazil is equally resistant to negotiating on the so called new trade areas: intellectual property rights, investment, governmental procurement and services. These represent the most promising areas of the FTAA for the US, but Brazil only wants to negotiate on these issues within the WTO.

### **The Dual Strategy of the US**

The US is a latecomer to the global free trade bandwagon. While the EU has signed more than one hundred treaties with third parties, up until just recently the US was party to only three such treaties: NAFTA and FTAs with Israel and Jordan. It was not until Congressional passage of Trade Promotion Authority (TPA) that the US was able to conclude new FTAs. Since then, bilateral agreements have been signed with Singapore and Chile and negotiations with Central America, Australia and five African states are planned. Preliminary talks on bilateral free trade zones have also been conducted with Peru and Columbia.

Despite occasional relapses into protectionism, the Bush administration's foreign trade policy towards Latin America is dominated by a two-track approach to free trade that includes simultaneous multilateral and bilateral efforts. With the same resolve he has shown for other initiatives that his father began but never completed, George W. Bush declared at the outset of his administration that the creation of the FTAA was the most important goal of his trade policy and announced the dawn of the «Century of the Americas». Moreover, as the former governor of a state bordering Mexico and due to his knowledge of Spanish, he has a personal connection to Latin America. In this regard, it was no accident that his first state visit was to Mexico in February 2001.

However, Latin America's position as a foreign policy priority ended abruptly with the attacks of September 11, 2001. Despite US Trade Minister Robert Zoellick's insistence that the FTAA remains a «high priority» for the Bush administration, most observers in Latin America believe that Washington has lost all interest in the region. Peter Hakim, President of the Inter-American Dialogue in Washington, complained, «At the moment Latin America is not a region of great interest. That's evident within the executive, Congress, business circles and the media.» That's also true for Latin America in US foreign and trade policies.

### **Stalemate between Opponents and Advocates of Free Trade**

The issue of free trade continues to be the source of heated debate in the US. It points to a rift between domestic and foreign policy and between the government and societal groups. While the executive branch is interested in pushing through the FTAA for foreign policy and economic reasons, opposition to the FTAA from labor organizations and environmentalists is rooted in domestic policy. Robert Zoellick is stepping up his lobbying efforts on behalf of free trade. He wants to convince a skeptical

American public with hard facts that show that «free trade and open markets provide real benefits to real people.» According to his calculations, the US economy would grow by up to 0.5% once NAFTA is fully implemented. That would amount to an extra \$720 a year per household.

The power relations between those for and those against free trade are constantly changing. The opponents have a strong lobby in Congress and have succeeded in winning over a large part of the US public to their cause. One of the main reasons for this was the experience with NAFTA. Shortly after the administration «bought» the FTA with Canada and Mexico at the end of 1993 by granting significant concessions to labor and environmentalists in lengthy negotiations – the so called «blue-green alliance» –, Mexico suffered a major financial crisis that could only be alleviated by a huge aid package from Washington. Having just reached a domestic consensus on NAFTA, which led to side agreements covering environmental and labor issues, this was a major setback for advocates of trade liberalization in the US.

While free trade advocates enjoyed the upper hand up to 1994, due in part to the global trend towards regionalism, their opponents were back in favor following Mexico's «Tequila Crisis.» There is currently a stalemate between the two sides. Playing a risky game, President Bush has proved to be a mediator between the two factions. While he received a renewed mandate for the executive branch to negotiate FTAs under the provisions of the «Trade Promotion Authority,» with its noticeably more positive connotations than «fast track authority,» the conditions for this authority are that equal consideration be given to the interests of advocates and opponents of free trade.

### **Motives for the FTAA**

The main foreign policy motives for the US to step up its efforts to create the FTAA are the creation of competing economic blocks

and a growing rejection of multilateral organizations like the WTO. From a regional perspective, the motivating factors for the US are political and strategic, including solidifying its leadership role in the hemisphere and bringing Latin America into the US sphere of influence. Economic interests, on the other hand, do not play a key role.

*Limited economic interests.* Although the US does have an economic interest in the reduction of duties protecting Latin American industry and agriculture and an opening of the service industry and government procurement, the trade figures show that the region plays a minor role economically. With an average share of 6% of US imports and 8% of US exports, Latin America (excluding Mexico) is of minor importance for the US in terms of foreign trade. The fact, however, that the exchange of goods with Latin America is responsible for nearly half of the foreign trade deficit of the US suggests that there is great potential for the US to increase exports. According to a recent German study, the US has considerable opportunity to increase exports above all to Canada, Central America, the Caribbean and also Brazil. These opportunities could be capitalized on through trade liberalization.

After Mexico, Brazil is the US's second most important economic partner in Latin America. However, with only a 2.2% share of US exports and 1.3% share of US imports, Brazil is, in contrast to Mexico, not a key economic partner of the US. But there is great potential on both sides for future cooperation. The main US economic interest in the FTAA is to obtain unrestricted access to Brazil's markets with its 175 million inhabitants, competitive national industry in some sectors, and a comparatively high standard of technology. This includes branches of the economy that are of strategic importance. In a recent report on worldwide trade barriers to US exports the Office of the US Trade Representative (USTR) complained, for example, that Brazilian export duties of some 30% on information technology pushes US computer firms out of the market. The

volume of trade between the US and Brazil, which was negative for the US for the last two years, could double in a short period of time with the creation of the FTAA. This is also the case for US direct investment in Brazil. To date, Brazil receives only a comparatively small share, approximately 13%, of US capital flows to Latin America.

*Building Competing Blocks and Regionalism.* In addition to its own economic and security interests in the region, transatlantic competition with the EU for global market share also plays a role in the US decision to pursue the FTAA. US interest in creating a competing free trade zone of continental dimensions has undoubtedly been influenced by the existence of the Single European Market since 1993, the creation of a European economic space with the introduction of the Euro and the upcoming widening of the EU to the east. The building of another economic block, ASEAN, has also played a role. In the context of regionalization, the FTAA project reflects a change in American perception and strategy. While the US relies on military strength to secure its political power, it is no longer pursuing a unilateral economic strategy. Instead, with the establishment of the FTAA the US is attempting to consolidate its leadership role within the Americas over the long term by forming an alliance with Latin American states. The FTAA project also represents a return to viewing Latin America as the US's neighborhood where it sees its role as a «security anchor.»

*Security Alliance.* For the US, the FTAA is not primarily about advantages for trade, rather it is the creation of a strategic alliance within the Americas with security and economic components. As Foreign Minister Colin Powell said in a speech given on April 28, 2003, «Hemispheric progress requires continued American engagement in trade, in security, [and] in support for democracy...» The US perceives the FTAA as a way to establish a lasting commitment in the region to capitalism and democracy and closer ties to the US. The strategy entails using economic ties to win over

Latin America as a political ally in the international system. The US sees the FTAA as an instrument for offering economic opportunity to Latin American countries. What it expects in return is a willingness to cooperate in areas of strategic interest to the US such as the war on terror, the drug trade, energy and natural resources security and migration control.

### **Bilateralism instead of Multilateralism?**

As the motor of the negotiating process, the US can «make or break» the FTAA. It determines the speed, content and schedule of negotiations. In the same year that the FTAA project was launched, the process of establishing a free trade zone throughout the continent was, however, set back for nearly a decade. At the time, an all-Americas free trade zone was to be established through the expansion of NAFTA. This was represented in an offer made in Miami by Bill Clinton to Chile to join NAFTA. The project failed, however, when Congress refused to renew fast-track authority for the president.

The US eventually made good on its offer to Chile when it agreed to a bilateral FTA in November 2002 that was subsequently signed on June 6, 2003. For the US, the bilateral treaty with Chile is more important in terms of expanding free trade to Latin America than for its economic value. Chile has a GNP roughly equivalent to that of Dallas and the country only ranks 32nd among recipients of US exports and a mere 40th among importers to the US. While the close economic integration with Mexico was a decisive motivation for the FTA with its neighbor to the south, in the case of Chile, the US was, from its perspective, rewarding the country for its exemplary economic policy along the lines of the model known as the «Washington Consensus.» As a matter of fact, its universal import duty of 6% is the lowest in Latin America. The treaty with Chile reflects the two-track strategy of the US of pursuing multilateral and bilateral negotiations at

the same time. Robert Zoellick introduced this two-track approach, and he is also the author of the concept of «competing trade liberalization» which has resulted in a new trade policy doctrine. Given the stalled negotiations over an all-Americas free trade zone, the US is now pushing forward with its second strategy. «In addition to the FTAA and the WTO, the United States is pursuing an aggressive strategy of global trade liberalization through bilateral agreements.» (USTR Press Release, February 11, 2003.)

Clearly, Chile is not meant to be an exception in Latin America. Although a continental FTA in the form of the «sum of individual agreements» is still being pursued, it appears that the US administration is now relying on bilateral rather than multilateral negotiations. Currently, Central America is in negotiations with the US for an FTA on the «southern border» of NAFTA that is expected to be signed at the end of 2003. Negotiations with the Dominican Republic are expected to follow. A bilateral treaty with Uruguay has also been discussed, but during President Battle's last visit to Washington in April 2003 it was no longer on the agenda. Instead, the possibility of a bilateral FTA with America's trusted ally Colombia has come up.

### **Brazil: Between Mercosur and FTAA**

For Brazil's part, the country considers the possibility of a treaty between Mercosur and the US a realistic alternative to the impasse over the FTAA, but it is generally concerned about entering an FTA with the US. The issue of the FTAA has a much higher profile and is much more contested in Brazil than in any other Latin American country. This is even the case for the governing party Partido dos Trabalhadores (PT), which for years under the leadership of the current president and former union leader «Lula» was known for its political opposition to a free trade zone with the US. Brazil is the only Latin American country in which a public, transparent and pluralistic debate over the FTAA is taking place and where the

executive branch has made public its negotiating position. Following coordination with other Latin American countries, Brazil intends to draw civil society representatives into the negotiating and decision making process for the FTAA.

### **The Heated Debate over the FTAA**

Given this context, it is no coincidence that the Latin American anti-FTAA protest movement started in Brazil. The annual World Social Forum in Porto Alêgre has become a global symbol for the opposition to free trade without some sort of social compensation. Events protesting the FTAA bring out tens of thousands of people in Brazil. In September 2002, non-governmental organizations and Catholic Bishops initiated a plebiscite over a free trade zone for the Americas in which a clear majority was against Brazilian participation in such a trade agreement.

In Brazil the number public supporters of an American free trade zone is limited. They are outnumbered by the skeptics and the unsure. National polls on Brazilian foreign policy have shown that only 29% of Brazilians consider free trade negotiations with the US a priority, whereas a good 49% view strengthening Brazil's leadership role in Latin America as very important. Among surveyed representatives of the national elite, 38% felt that the FTAA would not be good for Brazil because an FTA with the US would spell disaster for local companies. For the majority of Brazilians, the FTAA is a US project to expand NAFTA and North American influence over Latin America. There is fear of a «Mexicanization» of Latin America including Brazil, which would also lead to a loss of national sovereignty and the destruction of the national economy.

### **Brazil's Three-Track Approach**

While President «Lula» was publicly opposed to the FTAA before winning the election, now his policy has become one of constructive engagement. The government is pur-

suing three parallel strategies with regard to the American free trade project:

*Delay tactics.* The position of the Brazilian government in the FTAA process is marked by a certain continuity. Both Fernando Henrique Cardoso and the current president have called for the January 2005 deadline to reach an agreement to be extended and want to see concrete concessions on the part of the US. Despite statements to the contrary, the Lula administration is considering postponing the signing of the FTAA treaty by two years until 2007 or alternatively concluding merely a non-binding framework agreement in January 2005.

*Strengthening Mercosur.* The second element of the Brazilian strategy is to promote South American integration as a «counterweight» to the dominance of the US within the Americas. Brazil's effort to strengthen its leadership position within Latin America is driven, among other things, by a desire to improve its bargaining position vis-a-vis the US. Lula appears to be far more determined than his predecessor Cardoso to speed up the integration process within Mercosur under Brazilian leadership. This «South American strategy» is two-pronged comprising on the one hand, a deepening of Mercosur through a bilateral strategic partnership with Argentina, and, on the other hand, the construction of a South American alliance with the states of the Andean Community and Chile. Brazil would like to see an FTA between the Andean Community and Mercosur signed before the FTAA becomes a reality.

*Bilateralism and «FTAA light».* A new proposal from the Lula administration involves signing a hemispheric framework agreement along with a separate treaty between the US and Mercosur. Following a meeting with Robert Zoellick in Brasilia at the end of May, Foreign Minister Celso Amorim declared, «Our position is that the lighter the framework agreement, the easier it will be to conclude it within its deadline.» For the first time, Brazil called for a policy along the lines of the American «two-track approach». On the one hand, it proposes

taking up negotiations between Mercosur and the US according to the «4+1» model. On the other hand, the strategy involves agreeing on a version of the FTAA in which contested issues are excluded and pushed onto the agenda of the WTO or a Mercosur-US treaty.

The three strategies are interrelated. If possible, Brazil wants to postpone the FTAA negotiations in order to first bolster its leadership position in an alliance of Latin American states, in particular within Mercosur. At the same time, they are pursuing multilateral negotiations within the framework of the WTO on the contested issues of eliminating subsidies and opening up agricultural markets. This is to form the foundation of continuing free trade negotiations with the US and the EU. Brazil's key demand of the US is to eliminate state support for national producers. The Brazilian Agricultural Minister Roberto Rodrigues accuses the US of pursuing a dual strategy in which free trade is preached and protectionism is practiced. The same accusation is lodged against the EU.

### **A European Alternative to the FTAA?**

Brazil's economic interests in a future FTAA are determined by the structure of its exports. While two-thirds of Brazil's exports to Asia and Europe consist primarily of agricultural products, 45% of exports to the three states of NAFTA are manufactured or semi-manufactured goods. Consequently, a free trade zone with the EU would bring advantages to the agricultural sector, whereas manufacturers would be the ones to benefit most from the FTAA. Contrary to the negotiations with the EU then, for Brazil the FTAA process is about more than just the agricultural sector. Brazil's conflicts with the US over agricultural products are limited to a small number of products like orange juice, sugar, cotton and soy beans. The situation is more complex within the industrial sector. Brazil's electronics, computer and chemical industries are not very

competitive internationally and could suffer considerable losses with the opening up of its markets to US products.

Recent studies conclude that the opportunity for Brazilian exports in the FTAA would on the whole be less than the expected rise in imports. According to the Federation of Industries of the State of São Paulo (FIESP), Brazil's participation in the FTAA could result in annual losses of \$1.1 billion. The Brazilian think tank Fundação Getúlio Vargas (FGV) comes to similar negative conclusions. Their unpublished study assumes that if the country decided not to join a free trade zone of the Americas, the costs of non-integration would be null. An association agreement with the EU would be more profitable for Brazil and the other Mercosur states than the FTAA. According to model calculations, a free trade zone with the EU would result in a 12% increase in exports, whereas the FTAA would bring «only» an 8% increase.

An association agreement with the EU, in negotiation since 1999, would represent more than just trade liberalization due to the historical novelty of a North-South agreement between two free trade communities in which development components, political dialogue and the transfer of integration expertise also play a role. In addition, the EU treaty with Mercosur would be «exclusive». The US, on the other hand, has shown no similar interest in this sort of arrangement. But just as with the FTAA process, negotiations between Mercosur and the EU could fail due to the true point of contention, namely agricultural subsidies, given that agricultural products represent more than 45% of Mercosur's exports to the EU.

### **Scenarios and Consequences**

At the moment, an agreement on «FTAA light» together with bilateral treaties with the US seems more likely than the creation a continental free trade zone. Similar to the Latin American Integration Association (ALADI), which was originally conceived as

a regional FTA, the FTAA could end up as merely a framework agreement. In this case, a free trade project would remain a vision with strategic value, but it would include virtually no binding regulations. Four scenarios are possible.

*The FTAA as Umbrella Organization.* The creation of an FTAA framework agreement could be the sum of all the bilateral treaties between the US and Latin American states and country groups, including Mercosur. The necessary condition for this scenario would be the preference for bilateral negotiations with individual partners instead of a comprehensive multilateral solution. In the long run, the individual agreements could be integrated into the FTAA. The bilateral and subregional partnerships in Latin America would serve in this scenario as the building blocks of a continental FTA.

*A Patchwork without the FTAA.* Here the vision is of creating a tight network of bilateral and subregional FTAs or tariff unions in the Americas without the binding tie of a treaty that encompasses the whole continent. This scenario would require either a further distancing between the US and Latin America or a reorientation of US policy towards Latin America in which interests and needs of trade partners are handled separately instead of treating the region as a whole.

*North-South Divide.* If no concrete progress is made in the FTAA negotiations, two competing economic blocks within the Americas could arise: «North-Mercosur» (including parts of the Andean community) under the leadership of Brazil and a US-dominated «South-NAFTA» (including Central America and the Caribbean). This would depend on Brazil's ability to establish itself as a recognized leader in Latin America. A further variable necessary for the successful creation of a Latin American trading block would be the conclusion of an association agreement with the EU. In this scenario, the US and the EU would divide Latin America into spheres of influence: eastern Latin America from Argentina to Venezuela would be tied more to the EU, while the rest of the continent would look to the US.

*A comprehensive FTAA.* This would represent the conclusion of the free trade project within the given deadlines as a multilateral, binding, comprehensive agreement. But it will only be successful if Brazil and the United States are willing to make concessions (Brazil in the industrial sector and the US on agricultural subsidies). This in turn requires a closer alliance between the two states and an internal consensus in both countries in favor of the FTAA. The establishment of the FTAA would represent a redefining of inter-American relations and a growing together of North and South America. For the EU, this scenario would have negative effects, since Latin America's access to US markets would mean the continent's economic relations would be largely focussed on the US.

As with the US, the EU has FTAs with Chile and Mexico. In contrast with the US, the EU is negotiating separately with Mercosur, which is its true economic interest in Latin America. Direct conflict between the US and EU is above all evident in Mercosur, and here primarily in Brazil. To date neither the US nor the EU have granted Mercosur trade preferences, in contrast with other Latin American partners that have privileged access to US and European markets. The EU is the most important trade partner and investor in Mercosur. The trading block accounts for two-thirds of the EU's foreign trade with Latin America and half of Europe's investment in the continent. In order to maintain Europe's influence and support Mercosur's process of integration, an inter-regional association agreement should be signed before the realization of the FTAA. If this fails to come about, the consequences of the FTAA could be an economic version of the Monroe doctrine along the lines of «Latin America for the Americans». If, on the other hand, the FTAA and an EU-Mercosur treaty came into effect at the same time, the US and Europe would compete in Latin America on equal footing.

*Translation: Darren Hall*

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