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# A Free Trade Agreement of the America's: A Case Study of Brazil

Maria Eliana Cadario
*University of Arkansas, Fayetteville*

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# A FREE TRADE AGREEMENT OF THE AMERICAS:

# A CASE STUDY OF BRAZIL

By Maria Eliana Cadario
Department of Economics

Faculty Mentor: Dr. Tracy Murray
Phillips Petroleum Distinguished Professor of Economics

**Abstract:**

*This paper will examine the likely impacts of the proposed Free Trade Agreement of the Americas (FTAA) that was initiated by President Bush in 1994 and is anticipated to include 34 countries in the Western Hemisphere excluding Cuba and to come into force during 2005.*

*The paper will focus on the likely trade effects for Brazil, the largest potential member of the FTAA. In the first part, I will review the current trade relations between countries in the Western Hemisphere and the US, including the various bilateral and multilateral agreements such as NAFTA, MERCOSUR, CBI, The Andean Trade Preference Act, etc. Next, the paper will present the special complexities introduced by rules of origin which are inherent in any free trade area.*

*The methodology used to estimate the trade impacts is presented in section 3. Briefly, the elimination of US tariffs on imports from Brazil will stimulate US imports to the benefit of US consumers and at the expense of US producers and imports from other countries. Standard comparative static analysis will be used for the base estimates. These estimates will be qualified for special situations, namely the US quotas on sugar imports, the extremely high US tariffs on orange juice imports, and the forthcoming change in the world trading environment for textiles and apparel.*

*The expected results will be that the FTAA will provide significant benefits for Brazil, and by implication, for the other Latin American countries which will also benefit from the FTAA.*

## 1. Introduction

This paper will examine the likely impacts of the proposed Free Trade Agreement of the Americas (FTAA) that was initiated by former President Bush in 1994 and is anticipated to include 34 countries in the Western Hemisphere excluding Cuba and to come into force during 2005. The paper will focus on the likely trade effects for Brazil, the largest potential member of the FTAA. In the first part, I will explain what the FTAA is and I will describe the trading arrangements under this agreement. In the second part, I will review the current trade relations between countries in the Western Hemisphere and the US, including the various bilateral and multilateral agreements such as NAFTA, MERCOSUR, CBI, The Andean Trade Preference Act, etc. Next, the paper will present the special complexities introduced by rules of origin that are inherent in any free trade area.

The methodology used to estimate the trade impacts is presented in section 3. Briefly, the elimination of US tariffs on imports from Brazil will stimulate US imports to the benefit of US consumers and at the expense of US producers and imports from other countries. Standard comparative static analysis will be used for the base estimates. There will be calculations of trade creation and trade diversion for the major dutiable products that are currently traded between the US and Brazil. These estimates will be qualified for special situations, namely the US quotas on sugar imports, the extremely high US tariffs on orange juice imports, and the forthcoming change in the world-trading environment for textiles and apparel.

The results are that the FTAA will provide significant benefits for Brazil, and by implication, for the other Latin American countries that will also benefit from the FTAA.

### 1.1 What is the proposed FFAA?

The Free Trade Agreement of the Americas (FTAA) is a proposed agreement among the economies of34 countries in the Western Hemisphere, from Canada to Chile. This agreement excludes Cuba, The FTAA seeks to eliminate barriers and to increase trade and investment flows. This agreement would eliminate tariffs between FTAA countries within 10 years. It would also eliminate regulatory barriers that restrict trade. The Free Trade Agreement of the Americas is not a new idea that has emerged from recent negotiations. The dream of a unified American Continent reaching from the Article Circle to Tierra de Fuego inspired statesmen and thinkers of both North and South America decades ago. -J/

During 1960s, the Latin American countries began regional integration as a means of accelerating their development. Latin

American countries signed multilateral agreements creating some of the trade pacts that bind together the North with the South. Some of these early agreements are: The Central American Common Market (1960), Latin American Free Trade Area (1960) and Andean Pact (1969). After these trade agreements were created, the intraregional trade within Latin America increased, but the economic and political crises that erupted in the 1970's brought regional integration to a standstill.

The decade of the 1980 /s was not easy for hemispheric relations. Latin American countries struggled to cope with the worst economic crises since the Great Depression and the United States was dealing with the civil wars in Central America. These years were later designated as the "lost decade" for South and Central America because of the lack of growth due to the negative effects of the debt crisis. Nascent democracies in Argentina and Brazil were hit by hyperinflation. Civil strife burdened societies throughout Central and South America.

During the past decade, Latin American countries have improved considerably. These countries have implemented development strategies that combined macroeconomic stabilization policies with increased trade and regulatory reform. Privatization programs have reinvented important sectors, especially transport and utilities. New capital, technology and management skills have been introduced. Another factor that has helped these countries has been the provision of substantial funds to both pay debt and increase infrastructure investments. The objective behind this strategy was to encourage investment from both domestic and foreign sources to stimulate economic growth. As a result, international competition for investment funds has pressured governments in Latin America to accelerate their reforms. Faster growth in these economies created new opportunities for trade and investment. Domestic economic reforms continue to propel the integration process in the Western Hemisphere.

At the same time, regional integration arrangements have evolved and economic and political ties have solidified between countries in South America, Central American and Caribbean communities. These regions have established custom unions among the partner countries and they are also expanding their trade ties with countries in other regions in the Hemisphere. The agreements that have been developed range from simple tariff reduction pacts to comprehensive free trade agreements and custom unions. For example, MERCOSUR, the Southern Cone Common Market (Argentina, Brazil, Paraguay and Uruguay) is strengthening its custom union and has entered into free trade negotiations with Chile, Bolivia and other countries in the Andean Community. In addition, Mexico and Canada have concluded free trade pacts with Chile and Costa Rica; Mexico has agreements with other Central American neighbors, Bolivia, Colombia and Venezuela. Recently (2002), Chile has signed a free trade agreement with the United States. These countries must now adapt quickly to changing conditions in the world markets in order to gain market share and investment funds. Countries cannot use protection barriers to safeguard their industries from foreign competition. Countries must use their regional pacts to reinforce domestic reforms and to prepare themselves to compete effectively against foreign firms at home and abroad.

After acknowledging these pros from economies integration, the Free Trade Agreement of the Americas was launched by many representatives of the hemispheric countries. This FTAA platform comes from the initiative of the North American Free Trade Agreement (NAFTA) and the Enterprise for the Americas Initiative (EAI). NAFTA was the first reciprocal free trade agreement to link a developing country as an equal partner with developed countries. The EAI was the first initiative to link trade, investment and debt issues in a coordinated approach to economic development in Latin America. The creation of the EAI came from two concerns that the United States had about the Latin American countries. First, Latin American countries needed new inflows of foreign capital because their debt problem was not going to be solved without prolonged economic stagnation. Second, the economic and political reforms in this region would not be possible without accelerated growth. The United States concluded 14 agreements on trade and investment with hemispheric countries in 1990-1991. These agreements were the foundation for later negotiations of more comprehensive pacts such as NAFTA. NAFTA was born from the recognition that closer ties with neighbor countries can create great opportunities. NAFTA held the argument that it was going to benefit not only economic growth but also some political issues such as promoting democracy in Mexico and contributing to a long-term solution to immigration problems.

In December of 1994, the United States offered to host the Summit of the Americas in Miami. The Presidents of the Americas met to set a new path in the relations among Western Hemispheric countries. Although the Summit addressed several issues, trade and integration were the centerpiece and the Free Trade Agreement of the Americas was proposed. The Miami Summit initiated a detailed work program to prepare for the negotiations of the FTAA. The Declaration of Principles was: "Although faced with differing development challenges, the Americas are united in pursuing prosperity through open markets, hemispheric integration and sustainable development." The 34 presidents committed their governments to begin the construction of the Free Trade Area of the Americas. The representatives set 2005 as the deadline for the conclusion of negotiations. In March 1998, the FTAA negotiations were finalized in the San Jos6 Declaration of trade minister. The following month, the summit leaders reconvened in Santiago, Chile and officially launched the hemispheric trade negotiations. The Santiago Summit set the agenda for the FTAA. There were twelve negotiating groups at first. They were created to address market access and a consultative group on small economies was developed to ensure that the concerns of the majority of the FTAA countries were reflected in the work of each group. Responsibility for the organization of the FTAA process was given to the Minister of Trade (the United States) while the Vice Ministers of Trade were accountable for managing the preparatory process. This process consisted initially of meetings of trade ministers called Trade Ministerials (the first one in Denver 1995 and the most recent in Quito, Ecuador November 2002). The objectives of these meetings were to define the issues to be addressed in the negotiations and recommend to the presidents when the official negotiations of the FTAA might begin. The negotiations began in Miami in 1998. The talks were set up so that the big and small, the rich and the poor countries would share the responsibility to carry on the negotiations. The United States and Brazil were assigned the responsibility to co-chair the final stage of the negotiations from November 2002 to the end of the talks.

The Declaration of San Jose drafted the objectives and terms under which the FTAA negotiations need to be conducted. These objectives are:

To promote prosperity through increased integration and free trade

Establish a Free Trade Area that eliminates barriers to trade gradually, in areas of goods, services and investments no later than 2005

Market openness Incentive integration of the smaller economies into the FTAA

Make trade liberalization and environmental policies mutually supportive

Secure protection of worker rights

There are also certain principles that guide the negotiations among partner countries in this agreement:

Decisions are made by consensus, so each country has veto power

Transparency

Consistency with rules and regulations of the World Trade Organization

Commitment to improve on WTO rules and disciplines

Single understanding with simultaneous negotiations in all areas ("nothing is agreed until all is agreed")

Coexistence of the FTAA with bilateral and sub regional agreements

Countries negotiate and take responsibility factions individually or as members of sub regional groups

Special attention to smaller economies and difference in levels of development

Rights and obligations shared by all members

Countries need to make sure that the national laws conform to FTAA obligations

The main purpose of the FTAA is to promote growth and prosperity of the member countries by eliminating barriers to trade and investment. It is clear that that the FTAA will not exist as a final agreement until each issue has been negotiated with the approval of the 34 countries. The FTAA negotiations cover three main areas: market access reforms, including liberalization of trade barriers and removal of discrimination against foreign suppliers in the application of domestic law; rules covering trade and investment in goods and services sectors; and trade facilitation measures.

The twelve original working groups of the preparatory stage became nine Negotiating Groups, a Consultative Group and two special committees for the FTAA negotiations. Each has a Chair and Vice Chair. These positions rotate to obtain geographic balance. The nine groups are divided in areas of main interest:

1. Market access issues for goods
2. Agriculture
3. Services
4. Intellectual property rights
5. Subsidies, antidumping and countervailing duties
6. Government procurement
7. Investment
8. Competition policy
9. Dispute settlement

The other advisory committees were created to deal with (a) problems that arise from the participation of small economics, (b) inputs from representatives of civil society and (c) Internet use and difficulties presented in electronic commerce in the hemisphere. There is also the Administrative Secretariat that supports the negotiations. It provides logistic and administrative services; translating and interpreting services and managing the official documents. The Inter-American Development Bank (IDB), Organization of American States (OAS) and the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) compose the Tripartite Committee. This committee provides technical support and its participation during the preparatory stages has been crucial. As mentioned above the nine negotiating groups are the main keys to achieve effective negotiation in this agreement.

**Editor's Note:** Ms. Cadario's paper includes, in sections 1.2 through 1.14, descriptions of the roles various committees, groups, and authorities play in negotiating and imlementing free-trade agreements. space precludes publication of these sections here. The complete paper is available on the *Inquiry* website.

**2. Current bilateral and multilateral Agreements in the Western Hemisphere**

It is important to emphasize that the FTAA will not be a substitute for the current regional arrangements in the hemisphere. Those pacts will coexist and complement the hemispheric agreement. The readiness of Latin America and the Caribbean countries depends on the reforms that those regional agreements undertake. It is necessary to have success in those "small-scale" trade pacts to ensure that the FTAA will be successful too. Regional trading rules may be changed to comply with hemispheric-wide standards but in other cases when regional trade rules go beyond those in the FTAA, the regional rules would not change.

**2.1 North American Free Trade Agreement (NAFTA)**

The members of this agreement are Canada, Mexico and the United States. It is a free trade area of 387 million people. The total intragroup trade is $437.8 billion. US imports from Canada and Mexico are $230.2 billion. Exports to the US equal 83% of total Canadian and Mexican exports. NAFTA came into effect in January 1994. This agreement was created to promote free trade in goods and services and increase investment. After the US-Canada agreement, NAFTA has tried to improve government procurement, intellectual property and investor rights and it has created more stringent rules of origin. NAFTA also eliminates non-tariff barriers such as import licenses and, guarantees fair and open competition. Unlike MERCOSUR or the ANDEAN Pact, NAFTA does not have a common external tariff to nonmembers. NATTA has improved the trade relations among the member countries. The main trading partner of the United States is Canada. Mexico is also getting benefits out of this deal, by exporting more goods into the US at cheaper prices than before. According to the Council of the Americas, the trade of the US with Mexico and Canada accounts for one-third of all US merchandise trade and it exceeds the trade that the US has with Europe and Japan. As a result of NAFTA, US accounts for 76% of Canadian imports and 74% of Mexican imports. Mexican products have also entered the US market strongly and these effects contribute to the focus of the US to expand trade with Latin America.

**2.2 Caribbean Community and Common Market (CARICOM)**

The members of this custom union are Antigua & Barbuda, Bahamas, Barbados, Belize, Dominica, Guyana, Jamaica, Montserrat, St. Kitts & Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago. The representative market is of 6 million people. This agreement came into effect in August 1, 1973. The objective of this agreement was the eventual integration of its members and economies, and the creation of a common market. CARICOM has never been effectively completed. A fully implemented common market would significantly enhance the market potential of these countries. For CARICOM, a hemispheric agreement can provide stronger trade relations and investment links with North and South America to further expand their economies. Even tough CARICOM countries do not account for a large portion of the industrialized countries trade; these small countries could improve its trade volume and expand economically. One of their problems is that members have similar export products and similar economies (bananas, hotel occupancy, tourism, fishery, etc).

**2.3 Caribbean Basin Initiative (CBI)**

The members of this agreement are Antigua and Barbuda, Aruba, Bahamas, Belize, British Virgin Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago, and the United States. This is a preferential trade arrangement. CBI imports from the US is $14.2 billion 29% of total imports; US imports from CBI countries is $14.7 billion. Exports to the US equal 36% of total CBI country exports. The objective of this agreement is to revitalize the economies of the Caribbean countries trough tariff preferences. CBI was established in 198 US eliminated duties on al products except textile and apparel products, canned tuna, footwear, certain leather good and certain watches and watch parts.

**2.4 US- Andean Trade Preference Act (ATPA)**

The members of this agreement are Bolivia, Colombia, Ecuador, Peru and the United States. The ATPA has a common external tariff. There is a representative market of 103 million people. It was implemented in May 1988. The objective of this agreement is to establish a free trade area with a common external tariff and eventually become a full common market. Another objective is to expand economic alternatives for Andean countries and to combat drug production and trafficking. The United States is the main export partner for the Andean Pact countries. This has become a fast growing market for US exports too. The Andean Pact has a common external tariff (CET) ranging from 5, 10, 15 and 20 percent. The Andean group has intended negotiations with MERCOSUR to create a free trade area that joins together the two trading blocs. It would take some more time to agree to a free trade area among these countries since a study done by the Inter-American Institute for Cooperation on Agriculture found that the agricultural conditions among countries of ATRA and MERCOSUR are largely different.

**2.5 Southern Cone Common Market- Mercado Comun del Sur (MERCOSUR) or Mercado Comun do Sul**

**(MERCOSUL)**

This is probably the most important agreement that involves countries in Latin America. The members are Argentina, Brazil, Paraguay and Uruguay. Bolivia and Chile are associate partners. It is a custom union with a representative market of 200 million people. It came into effect in January 1995. The objective of MERCOSUR is to establish a common market in the south that is expected to be fully implemented at an unspecified date. MERCOSUR has a combined GDP of $ 1 trillion (approximately two thirds of the GDP of South America). MERCOSUR imports from the US $ 18.8 billion, 22% of total imports, US imports from MERCOSUR is $ 11.4 billion. Exports to the US equal 15% of total MERCOSUR exports. All tariffs will be eliminated and MERCOSUR members will fully integrate with a common external tariff schedule. The maximum tariff rate will be 20%, with an average tariff rate at 10%. Individual national rates apply to imports of capital and high-technology goods until next decade when capital goods receive a CET of 14%. In 2006, a CET of 16% will be applied to informatics and telecommunications. Chile signed a free trade agreement with MERCOSUR in October 1996 and Bolivia did the same in March 1997.

The trade relationships with the US started in early 1990's with talks about trade and investment framework agreements. MERCOSUR started better than expected because of the economic reforms undertaken by the two biggest players: Argentina and Brazil. In the 1990's, both countries ended their hyperinflation. Programs of privatization also fueled an increase in foreign investment in these two countries. However, the recent economic crisis in Argentina ha put MERCOSUR in a standstill situation. In order to sustain economic growth, the countries of MERCOSUR will have to integrate their markets even more by improving transportation links, speed up custom processes and sustain macroeconomic stability. With the potential for growth and economic benefit, MERCOSUR represents an important trading bloc for the FTAA. Brazil's trade with the US is primarily in manufactures while other countries seek reform of agricultural trade barriers and subsidies. According to Brazil's ambassador to the United States, in the year 2000, Brazil had a weak performance in exports to the United States because of discriminatory treatment due to NAFTA, competition from the rest of the world, and US import restrictions. For Brazil, the FTAA represents good opportunities for Brazilian textiles, clothing, footwear, citrus products, sugar, etc. To the extent that the FTAA will help these Latin American countries recover from their economic and growth stagnation, it will strongly serve Brazilian and MERCOSUR trade interests.

### 2.6 Other Free Trade agreements amon2 countries in the Western Hemisphere

There are other free trade agreements that are worthy to mention. There is the Chile MERCOSUR free trade agreement in which the members of MERCOSUR have a free trade arrangement with Chile. The objective of this agreement is to maintain and expand preferential tariff arrangements between Chile and MERCOSUR. This agreement went into effect in October 1996. Chilean imports from the MERCOSUR were $4.5 billion (16% of total imports); MERCOSUR imports from Chile were $1.7 billion (2% of total imports).

Another free trade area is the one formed by Chile and Mexico in September 1991. The objective of this agreement is to promote bilateral trade and investment flows. The other objectives included the elimination of tariffs on 90% of the traded goods, tariffs phased out in synthetic textiles, glass, ceramics, meat, poultry, eggs and some timber products. The tariffs on vehicles should be reduced and there should be harmonization in tax and investment rules. Although this agreement went into effect in 1992, tariffs on nearly all products were gradually reduced and eliminated in 1996. Tariffs on more than 100 products were abolished by 1998. However, there are products that are excluded from tariff cuts such as sugar, tobacco, and petroleum products.

The most recent Free Trade Agreement was signed between the US and Chile (2002). This pact says that tariffs and quotas on all goods should be abolished after the transition period with no exemptions. With this agreement, about 85% of the trade in consumer and industrial goods becomes duty-free when the agreement is signed. The remaining tariffs will be eliminated within four years after the agreement in implemented. The US exports that will gain free access to the Chilean market arc: agricultural and construction equipment, auto and auto parts, computers, technology products, medical equipment and paper products. Textiles and apparel will have zero tariffs if they meet the rules of origin agreed in the pact. This agreement is definitely an open door to the conclusion of the FTAA by the specified date. This agreement is a comprehensive one that includes trade in services such as banks, insurance, securities and related firms, open telecommunication market, open investment flows, high level of intellectual property protection, protection against anti-competitive and monopolistic behavior, dispute settlement, etc. In general, the structure of the Chile-US free trade agreement is similar if not equal to the proposed structure of the FTAA. This agreement covers all the relevant areas that need attention and it definitely can be used as a model to start the FTAA agreement.

### 2.7 Special Problems: Rules of Origin in the FTAA

When countries join a Free Trade Area, there are complex rules of origin that are part of the agreement. In a free trade area, the member countries will have zero tariffs among themselves. However, every country can keep its own tariff rates for non-members. Rules of origins were created to prevent a non-member from exporting a product to a low tariff member and then re-exporting the product to a high tariff member without paying the higher tariff. The rules of origin determine whether goods qualify for preferential tariff treatment. Products that are wholly made from material produced in the FTA qualify for free trade. Products imported from non-members do not. Products containing some materials imported from non-members may or may not qualify for free trade. This will depend upon the rules of origin. These rules that should be created for the FTAA will probably be based on the existing ones in NAFTA. In any instance, rules of origin represent a set of requirements that are based on three conditions that need to be met in order to have goods exported under free trade area agreement (Murray, 84):

1. The products should be shipped from the FTAA member country to the other FTAA member without intermediate trade or processing.

2. The products that are being traded need to have appropriate documents that certify that they qualify for preferential tariff treatment under the agreement.

3. The exporting country should have made a minimum processing in the products being traded.

For condition 1, there is an exception when the exporting country is land-locked (Bolivia and Paraguay). In these cases, the products can be in kept in third countries only under the condition of being in transit. Although this is an exception to rules of origin, it becomes complex when there is a free trade area agreement. The rules of origin in NAFTA ensures that free trade benefits are given to firms and individuals who produce or manufacture good in North America using local input materials and labor. NAFTA has agreed to implement many uniform customs procedures and regulations in the three countries that are members. This uniformity in the procedures facilitate the exporting process because it saves transaction costs to the small and medium sized companies that exports to the different NAFTA countries. In addition, the documentation pertaining to rules of origin, records keeping and origin verifications are the same for all three NAFTA countries. In the case of the FTAA this can be a potential problem since there are 34 countries involved in the agreement. In addition, there are different languages spoken in the countries: Spanish, English, French, and Portuguese. NAFTA uses a formula in order to calculate the local value content of the good that is being imported to the member country. The exporter or the producer of the good can choose the transaction value method or the net cost method to calculate this content.

The transaction value method is:

$$RVC = \frac{TV - VNM}{TV} \times 100$$

where,

RVC is the regional value content, expressed as a percentage.

TV is the transaction value of the good adjusted to a F.O.B basis

VNM is the value of non-originating materials used by the producer in the production of the good.

The net cost method is:

$$RVC = \frac{NC - VNM}{NC} \times 100$$

where,

RVC is the regional value content, expressed as a percentage;

NC is the net cost of the good; and

VNM is the value of non-originating (imported) materials used by the producer in the production of the good.

Under NAFTA, a product is said to originate in the free trade area when it grows, is harvested, wholly produced, or substantially transformed in the free trade area. When substantial transformation is the case, then the process causes a product to shift from one tariff classification to another. The term substantially transformed still in controversy sometimes. For products to qualify for free trade there should be a limit on the use of imported inputs when processing the good. This has the objective of having the value of the imported inputs not to exceed a certain percentage of the export value of the final good. Rules of origin should be used for the only purpose of avoiding the "free rider" problem. Generally, rules of origin can be used as a non-tariff barrier to protect domestic industries. With regard to the FTAA rules of origin, there is a need to establish a uniform system for FTAA rules to make the trade process less complex. The system would need clear, transparent and symmetric rules of origin to avoid confusion.

## 3. My proposed analysis: Brazil and United States

In this analysis, the main focus will be the relationships between The United States and Brazil because of their mutual relevance in the negotiation of the FTAA. It is important to mention that Latin America has a diverse set of economies, social and political structures. The effects of this free trade area will mainly depend on the individual country. However, the purpose of this thesis is to evaluate the effects that this free trade agreement will have on the trade patterns between Brazil and the United States. The effects that will be presented will be from the perspective of consumers, producers, rest of the world and NAFTA. According to the thesis that will be exposed, Brazil and other Latin American countries will be the main beneficiaries of this free trade area. In general, consumers will benefit, domestic producers will lose and the imports from countries outside the free trade area will decrease as well. In this analysis, there will potentially be trade diversion and trade creation between these country players and this will be discussed in the later section of this project. Brazil will be generally mentioned as the exporting country and the United States as the importing country.

### 3.1 Trade Creation and Trade Diversion

Two of the main incentives produced by a free trade area like the FTAA are: trade creation and trade diversion. We will assume for analytical purposes that the FTAA reduction of tariffs in Brazilian products and US products will become effective immediately after the agreement is signed. This move toward integration and free trade for the hemisphere is occurring against an extraordinary environment in which advanced economies are merging with developing nations. In this case, the United States represents the industrialized nation and Brazil represents the developing nation. Although Brazil is considered an agrarian economy still, it has moved along way in the past decade. Brazil is the dominant member of the MERCOSUR accounting for approximately 70% of the total GDP, about 80% of its population and two thirds of its total trade. (IDB-Intal 2000, Schott). Brazil has contributed to the region outgrowth because of investment in important transportation and telecommunications infrastructure and in energy sources. Brazilian exports are gaining an ever-increasing share of the world markets for manufactured goods. Brazil is the world's largest producer and exporter of coffee but coffee exports account for only 5% of total exports. Brazil's largest single trade partner is the United States. The United States imports a wide range of products from Brazil, from orange juice concentrate to automotive parts, shoes, textile, airplanes, etc.

When the FTAA takes effect, there will be trade effects. If we analyze this from the prospect of Brazilian welfare, we can say that the FTAA will eliminate the tariff rates and as a result, the United States will import more from Brazil increasing US consumption, displacing domestic production, displacing imports from the rest of the world and displacing imports from NAFTA. This will be the general impact that applies to all products whether they are final goods or input materials. Other Latin American countries will also share this effect because they will also be part of the FTAA. Of course, it is important to note that it will depend on the type of product that is being analyzed. There may be cases where Brazil will be the only FTAA country that exports a certain product to the US and in this case, the other Latin American countries will not have any shared effect.Trade creation (Figure 1) means that the free trade area will create trade between the exporting country and the importing country that would not have existed otherwise. As a result, the supply of goods shifts to a more efficient producer of the good. In all cases, trade creation will raise welfare. In this base scenario, it is necessary to make a distinction between the effects of the trade creation:

1. Positive impact on US buyers of imports. These could be consumers of final goods and firms using input materials.

2. Negative impact on US producers of import-competing products.

3. Negative impact on US imports from NAFTA (Canada, Mexico, Chile)

4. Negative impact on US imports from the rest of the world.

The consumers of the importing country will benefit from the free trade area because of the reduction in the domestic price of both imported good and domestic substitutes, raising consumer surplus. The producers in the importing country will suffer losses as a result of the FTAA. The decrease in the price of their product in the domestic market reduces producer surplus. The price decrease will also cause the decrease in output of existing domestic firms and potentially some firms will shut down. This will have a negative effect on employment and a decrease in profits. As a result of this effect, the domestic producers will have to accommodate to the competition in low cost production. The government of the importing country will suffer a loss of revenue that will be transferred to the exporters of the exporting country. It is important to realize that when the FTAA becomes a reality, many markets and multiple countries will be affected. In order to analyze the aggregate effects of the FTAA, we would need to sum up the effects across markets.

When the FTAA comes into effect, there will also be another effect that is called Trade Diversion (figure 1). The free trade area will divert trade away from a more efficient supplier outside the FTAA towards a less efficient supplier within the FTAA. The effect of trade diversion can be positive or negative for national welfare and that will depend on how much trade creation is born from the FTAA. To illustrate trade diversion, here is a simple example: assume that the United States was importing plastics from Spain at a cost of $3 per feet plus $1 tariff; the import price is $4. The cost for Brazil is $3.5 per feet. When the US and Brazil form the FTAA, the tariff rate imposed in the Brazilian plastic will be zero and the plastic price will be $3.5 per feet. In this case, there will be trade diversion from the plastic supply from Spain to the plastic supply from Brazil.

The welfare effects of trade diversion are negative. If trade creation is larger than the magnitude of trade diversion, then the net welfare will be positive. On the other hand, if trade creation in smaller than the magnitude of trade diversion, then the net welfare will be negative. Generally stating, the larger the difference between the FTAA country and the rest of the world, the more likely that trade diversion will reduce welfare.

Evaluating the effects of trade creation and trade diversion from the perspective of Brazil, it can be concluded that with the introduction of the FTAA, Brazil's economy will experience what is called a Trade Expansion that benefits Brazilian economy. It is necessary to recognize that there are preferential agreements between the US and Brazil in trade of certain products such as airplanes and coffee. In the case of these products, the FTAA will not have a positive or negative effect on the trade between these two countries. This is also true for other Latin American countries that benefit from free access to the US market. In this case, these other Latin American countries (e.g. Mexico, Chile) are already exporting their products duty-free and the introduction in the FTAA will not cause an increase in the volume of trade with the US. It might even hurt them since the US will be able to import from more suppliers without tariffs.

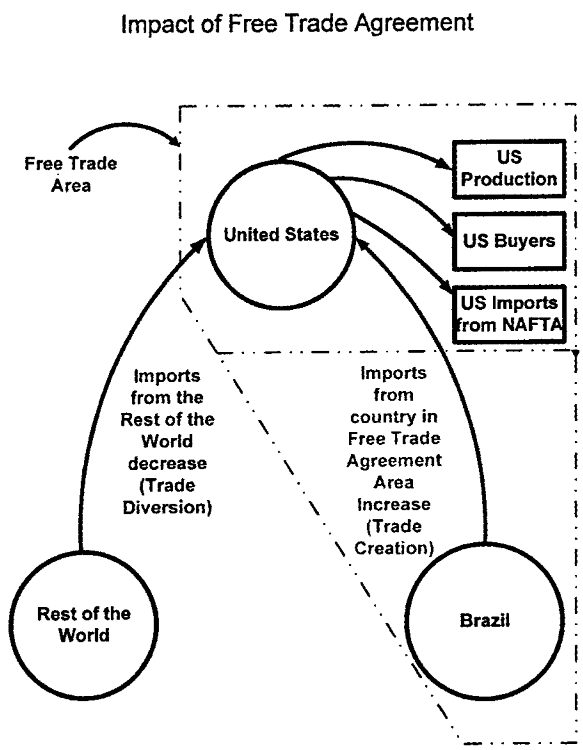


**Figure 1: Incentives created by a free trade area: Trade Creation and Trade Diversion**

### 3.2 Impact of the FIPAA on Brazil

From the Brazilian perspective, the FTAA could potentially facilitate the access to the US market, lower the costs of inputs and final products, facilitate the transfer of technology and increase the investment flows towards all Latin American countries. The United States has also interests in the FTAA. Among these interests are the stronger economic, political and foreign policy ties with Latin American countries, especially with Brazil. The US is looking forward to the open access to the large Brazilian market of goods, services and capital movements throughout the region. The United States wants also to get the share of the trade that the European Union has conquered in Brazil. The FTAA would put the US in advantageous position vis-‡-vis European and Asian companies that are currently doing business in this area. Brazil is an important trade partner of the US. During the 1990's, Brazil implemented market oriented reforms where protectionist policies were replaced by privatization of inefficient government-owned agencies and the liberalization of trade and investment. According to the SECEX (Secretary of Extemal Commerce) of Brazil, in 1999 Brazil's top exports were mainly comprised of natural resource based goods, and manufactured goods only accounted for 27% of Brazil's top ten exports. In the year 2000, the US accounted for 23.9% of Brazilian exports. The European Union accounted for 26.8%, and the rest of Latin America accounted for 23.4%. This indicates that almost 50% of Brazilian exports go to the Americas. With the FTAA, the Brazilian exports will be focused on the US market at the expense of European countries. Brazil is a very attractive trade partner for the US. American companies have been realizing that the opportunities to invest in Brazil are enormous. More than 400 of the Fortune 500 companies currently have operation in Brazil. Brazil has also been identified by the US Department of commerce as one of the ten "strategic partners" of this century.

| | Argentina | Brazil | Mexico | Argentina + Brazil + Mexico | Latin America and Caribbean |
|---|---|---|---|---|---|
| Population (million - 2001) | 37.5 | 172.6 | 99.4 | 309.5 | 523.7 |
| GDP (US$ billion - 2001) | 261 | 502.5 | 617 | 1380.5 | 1,900 |
| FDI (US$ billion - 2000) | 11.7 | 32.8 | 13.3 | 57.8 | 75.1 |

*Source: World Bank - www.worldbank.org/countrydata/countrydata.html*

Brazil imports have been diversifying throughout the last years. Approximately 49% of the imports are raw materials and 27% are finished goods. The imports of durable goods are led by automobiles that are among the main products imported by Brazil. The trade flow between Brazil and the other members of the MERCOSUR averages 15% of the country's foreign trade flow for the period 1998-2000. (SECEX). In the year 2000, trade with MERCOSUR totaled $15.5 million. Brazil's exports to the MERCOSUR are composed of manufactured goods and the imports from MERCOSUR are mainly transportation material, vegetable and animal origin products, mineral products, textiles, machines, etc.

### 3.3 Effective Protection Rate (EPR)

A tariff is a form of protection for the domestic industry. If the tariff is an ad valorem tariff proportional to the value of the imports, then the tariff rate itself represents the amount of protection. If the tariff is a specific amount, then in order to measure the amount of protection, the tariff is divided by the price and the result is the ad valorem equivalent. However, sometimes the effect of a tariff can vary in the different stages of production of a good. Most wealthy countries have an escalated tariff schedule with lower tariffs on raw materials, modest tariffs on inputs materials and higher tariffs on final goods. This escalation causes the effective protection that is highest on final goods, lower on intermediate inputs, and lowest on raw materials. Such escalated structure of tariffs alters the composition of imports favoring the importation of raw materials and discourage final goods. Therefore, the value added is moved from the exporting country to the importing country. These effects are difficult to estimate. However, the direction of such is known. By saying this, the FTAA will reverse the escalation in tariff schedules resulting in undoing the bias against trade in final good and the bias in favor of trade in raw materials and intermediate inputs. Therefore, Brazil and the other Latin American countries will be able to export more final goods and increase their income. To illustrate this concept, here is an example:

> Suppose the price of a final good is \$10 and the price of the input material is \$4. Before any tariff the Value Added is \$10 - \$4 = \$6
>
> Suppose the US imposes a tariff (T) on the final good of 20%, then the final good price is now \$12. The Value Added is \$12 - \$4 = \$8 or ([\$8 - \$6]/\$6) - 33%
>
> Suppose that the US imposes a tariff (t) on the input material of 20%; then the price of the input material is \$4.8. The Value Added is \$12 - \$4.8 = \$7.2 or ([\$7.2 - \$6]/\$6] 20%
>
> Suppose that now the tariff (t) on the input material is 10%. The price of such would be \$4.4. The Value Added is then \$12 - \$4.4 = \$7.6 or ([\$7.6 - \$6]/\$6) = 27%
>
> Suppose that now the tariff (t) on the input material is 40%. The price of such would be \$\$5.6. The Value Added is then \$12 - \$5.6 = \$6.4 or ([\$6.4 - \$61/\$6) = 7%

The effective protection rate (EPR) will be greater when the tariff on the final good is greater than the tariff on the input material. When the tariff on the final good is equal to the tariff on the input material, then the effective protection rate will be the same to both.

**If T>t**

**EPR>T**

**If T=t**

**EPR=T=t**

### 3.4 Trade Creation and Trade Diversion for Dutiable Products from Brazil

The data is based on statistics from 2001. The descriptions of the products in this sample are found in the website of the US International Trade Commission www.usitc.gov, under the Harmonized Tariff Schedule of the United States.

$$\mathbf{TC = E_M \times M_B \times \Delta t^B}$$

$$\mathbf{TC = E_M \times DUTY^B}$$

$$\mathbf{TD_{NAFTA} = TC \times [M_{total} / US] \times M_{NAFTA} / M_{total}}$$

$$\mathbf{TD_{ROW} = TC \times [\, M_{total} / US] \times M_{ROW} / M_{total}}$$

**Table 1: Trade Benefits for Brazil from FTAA (2001 \$ million)**

| Product | HS Code | TC | TD | TE |
|---|---|---|---|---|
| Footwear | 6402, 6402, 6404 ** | \$114.26 | \$92.71 | \$206.97 |
| Orange Juice, frozen concentrate | 20091100 | \$45.50 | \$7.37 | \$52.87 |
| Tobacco, unmanufactured | 2401 * | \$16.78 | \$6.79 | \$23.57 |
| Ceramic tiles | 6908 *** | \$7.98 | \$6.63 | \$14.61 |
| Cotten linen | 63026000 | \$7.20 | \$6.28 | \$13.48 |
| Cotton trousers | 62046240 | \$4.43 | \$4.38 | \$8.81 |
| Cotton sweaters, knitted | 61102020 | \$3.95 | \$3.93 | \$7.88 |
| Cotton t-shirts, knitted | 61091000 | \$3.48 | \$3.36 | \$6.84 |
| Plywood | 44121430 | \$2.49 | \$1.26 | \$3.75 |
| Ball bearings | 8482 **** | \$1.77 | \$1.70 | \$3.47 |
| Towels | 63029100 | \$0.09 | \$0.08 | \$0.16 |
| Subtotal | | \$207.93 | \$134.50 | \$342.43 |
| Other Dutiable Products | | \$80.86 | \$52.31 | \$133.17 |
| *TOTAL* | | *\$288.79* | *\$186.81* | *\$475.60* |

* HS code 2401 -2083, -2085.
** HS code 6402 - 9140, -9918, 6402 -5960, -5990, -9190, -9920, -9960, -9990, 6404 -1935, -2040.
***HS code 6908 -1050, -9000.
****HS code 8482 -1050, -2000, -9915.

The total value of US imports of sample product from Brazil for 2001 was \$1,613 millions. There were a total of dutiable products of\$4,981. We can conclude that 32% of US dutiable imports from Brazil come from this group of products. (See Appendix).

$$\mathbf{\Sigma TC_B = \$288.79 \text{ millions}}$$
$$\mathbf{\$207/\$288.79 = 72\% \text{ (tariff revenue)}}$$
$$\mathbf{\Sigma TD = \$186.81 \text{ millions}}$$
$$\mathbf{\Sigma TE_B = \$475.60 \text{ millions}}$$

I conclude that this sample of products contain about 32.4% of all the products that US imports from Brazil. However, these products account for 72% of the duties collected. In the year 2001, the total tariff revenue collected from Brazilian imports was \$287.97 millions and the sample products accounted for \$288.79 millions per year. Clearly, this sample represents the most significant group of products that will benefit from the FTAA. The resting 68% of products that come to the US from Brazil are not representative in dollars volume or they enter the country with preferential treatment already. Based on this group of significant products, I have also calculated trade creation for Brazil, trade diversion for NAFTA and the rest of the world and finally trade expansion for Brazil. When calculating trade creation:

$$TC = E_M \times M_B \times \Delta t^B$$
$$TC = E_M \times DUTY^B$$

The assumption of these calculations is that the elasticity of imports from Brazil (E~) is 1

$$TC_B = \$288.79 \text{ millions}$$

Trade diversion for NAFTA and the rest of the world has also been calculated:

$$TD_{NAFTA} = TC \times [M_{total} / US] \times M_{NAFTA} / M_{total}$$

$$TD_{ROW} = TC \times [M_{total} / US] \times M_{ROW} / M_{total}$$

$$M_{total} = M_{NAFTA} + M_{ROW} + M_{BRAZIL}$$

For this trade diversion, the assumption is that $M_{TOTAL}$ / US is 1. The exact number was not available and that is why it is being considered a unit. This is also based with statistics from 2001. The products that are mainly traded between the US and Brazil are not going to hurt the trade with NAFTA in a significant manner because there is not a significant volume of trade in these products between NAFTA and US. However, one of the products that the US trade with NAFTA is orange juice and this is probably one of the products that will largely benefit Brazil with the FTAA. The trade diversion for NAFTA in orange juice is $7.4 millions per year. However there may be an underestimation since Brazil can potentially take over all of the imports of orange juice in the US. Trade diversion as a total for NAFTA is $7.9821 millions and most of it is taken by orange juice. Trade diversion for the rest of the world is $1134.5 millions. Brazil will probably pick up on this amount of trade from other countries like in Europe. US producers will most likely not benefit from this because of cheaper imports to the US. US consumers will have access to a broader range of products at cheaper prices as a result of the abolition of import tariffs for Latin America. Trade expansion for Brazil has been calculated to be $459.58 millions that include products that were not taken into account in the sample (the remaining 28%).

By multiplying the sum of total trade expansions calculated in the sample by one-third, I am accounting for other products that are not in this sample and also for possible errors. When I calculate trade diversion, I excluded the data for other Latin American countries because the FTAA will include them and they will get the same import treatment (0 tariffs) as Brazil. The benefits that Brazil will get with this agreement will be shared with other Latin American countries.

It is important to acknowledge that Brazil exports textiles and apparel to the US and they have a large potential of increasing these exports. However, there may be another factor affecting Brazil's potential in this industry. According to the Uruguay Round and the Multifibre Arrangement (MFA), the quotas on textiles and apparel will be completely eliminated for China by 2005. China has a competitive advantage in this industry and Chinese exports of textiles to the US will grow dramatically when the quotas completely phase out in 2005. Brazil will be able to export textiles but not as much as estimated. As a result of this, Brazil will have to take action in the footwear industry, where they have a competitive advantage. Footwear exports have the potential to grow exponentially after the FTAA. The calculation of trade creation for Brazilian footwear is $114.3. This number is underestimated because Brazil's capacity in manufacturing shoes. This accounts for ($114.26/$207.45) = 55% of the total trade creation calculated for Brazil.

### 3.5 Special Cases

#### 3.5a Sugar

Sugar is an important product for both Brazil and the US. However, the US has always been very protective with the imports of sugar. Sugar has suffered quantitative restrictions, duties, and fee on imports. Brazil is a world leader producer of sugar. They have a huge capacity of production and without discussion sugar has always been one of the major export products for Brazil. This is the reason why Brazilian sugar is taking a considerable importance in the negotiations of the FTAA. As one of the largest sugar producers, Brazil has considerable influence over the international sugar market. Brazil exports approximately 100,000 to 200,000 metric tons to the US every year but it has a larger role in the global market. In the year 2000, Brazil exported about 8 million metric tons of raw sugar. Currently, the world price of sugar is about 08.5 per pound while the US price is about 022.5 per pound. Brazil is currently the second largest quota holder to the US market according to the Office of the US Trade Representative. Brazil's quota is 152,691 metric tons for 2003. The total quota that the US has on sugar is 1,117,195 metric tons, which is the minimum level under the Uruguay Round Agreement in 1995. This quota is divided among 40 countries. Based on this information, Brazil could take over the imports of sugar to the US after the quotas are phased out. If the FTAA becomes a true free area, Brazil could become the main exporter of sugar to the US. The other main exporters of sugar are: Australia (87,402), Dominican Republic (185,335), Guatemala (50,546) and Philippines (142,160). Brazil will be able to compete with the Caribbean islands that are large producers of sugar too. The reason to say this is because Brazil has a territory advantage over the islands. Brazil's capacity is much larger than any of these small islands. Another potential competitor that we need to consider in a future is Cuba. Currently, Cuba is excluded from this free trade area. However, when Fidel Castro is not in power anymore, there is the possibility that the trade relationships would be built again with the US and this could make Cuba a potential exporter of sugar. A factor to consider in this industry and the imports that come to the US is that the other competitors are the Caribbean Islands. However, these economies are probably producing at their maximum capacity and currently they receive a price four times larger than the world price when they export to the US. When the FTAA is signed, these islands may even be hurt because of the fact that the US will pay world prices for sugar imports.

#### 3.5b Orange Juice

Citrus products are an important negotiation area in the FTAA. Intheyear200I,theUS imported $75 millions in orange juice from Brazil. The tariff rate on this product is about 61.1% and the reason for it to be so high is because the US has history of protecting the US production of orange juice, especially in Florida. Orange juice trade between the US and Latin America is mostly in one direction with the US importing from Brazil, Mexico, Honduras and Costa Rica. Brazil imports account for about 60% of total orange juice imports. Brazilian orange juice supplements Florida's production. During 1996-1998, Florida decreased its orange production but recently there has been an increase in the state's output. With the removal of tariffs, there may be an incentive to import more inexpensive Brazilian orange juice, which will potentially displace Florida's juice. The higher cost of production in the US will probably keep Florida's prices above Brazil's. Therefore, there will be an increase in the demand for imported orange juice. Since the tariff on Brazilian orange juice is currently so high, the estimation that has been done for this specific product may be underestimated. The real results will only be measured when the FTAA be fully implemented.

In this analysis, I am not estimating any investment effects, any Brazilian imports from the US or any Brazilian trade with other Latin American countries. These calculations would have to take more complex processes. However, it is well known that FTAs create incentives for foreign direct investment (FDI) as well as domestic investment. There are two incentives that are important:

> I. There are several firms in the US that will have an incentive to invest in productive capacity in Brazil designed to increase production to serve the Brazilian and US markets.
>
> 2. Countries that are non-members of the FTAA (EU, Japan, etc) will have similar incentives to invest in productive capacity in Brazil. Since exports from their home countries do not have the preferential treatment that the FTAA countries will face, these outside countries will have an incentive to invest in FTAA members. These effects are complex to estimate.

## 4. Conclusion

After analyzing the process in which the FTAA is taking place and the potential effects that this will have in the trade between Brazil and the US, my conclusion is that the FTAA will have potential gains for countries that are in the process of development such as Brazil. The poorer countries are the ones who will benefit the most because of the innovative technology and the open access to advanced markets like the US. Brazil in this case, is taking the majority of the benefits from the FTAA. Brazilian producers will benefit because they will be able to export more to the US, especially in the cases of sugar, orange juice and footwear. US producers will potentially suffer losses because of the introduction of more competitive raw materials, intermediate inputs and final goods. The FTAA will undo the escalation of tariff schedules that the US have on finals goods and raw materials. This will give the industries of final goods in Brazil the incentive to export higher volumes of goods to the US. US producers will have to adjust to competitive prices and quality such as orange juice. The cost of production and labor in the US are higher than in other countries and this is a controversy because of labor standards that should be implemented in all countries. However, the fact is that the lowest cost is in Brazil and this will force US producers to catch up in the competitive way of producing output. Because of the FTAA, there will be trade diversion for goods coming from NAFTA and the rest of the world. Based on the findings from the sample of products used to calculate trade creation, trade diversion and trade expansion, the conclusion is that trade diversion will mostly hurt the rest of the countries that are not NAFTA or FTAA members. The majority of the products that Brazil exports to the US are mainly exported by non-NAFTA members. The numbers that came out of the calculations may be underestimated in cases such as sugar, orange juice, tobacco and footwear. On the other hand, calculations for the textile and apparel industry are overestimated because of the elimination of quotas that will take place in 2005 for China. Brazil will have a trade expansion of$459.58 millions and this number is below what may happen when the free trade area comes into effect.

All these benefits will also be shared with other FTAA beneficiaries that are active exporters to the US. It is important to also consider the probability that after the FTAA is implemented, the political, social and economic relations among these countries will become closer and easier. This is clearly a sign of the way in which the world is going, Globalization. However, these are only estimates based on past data on trade statistics. It could be possible that there may be conflicts arising in the process of accomplishing the FTAA because of the complexity issue of such negotiation. There are 34 countries involved with different cultures, languages, currencies, technologies, political structures, etc and this adds to the complexity of forming a free trade area. This will take a long time until the world can see results but let's compare to the European Union. They took decades to for in a true union and they had to struggle over the years. It is a union that still in process of fortifying but it sure has the potential of becoming a world power in the international environment. The FTAA can be a possible union but a long process of changes and reorganization has to come along with it.

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## Faculty Comment:

In his letter to the Inquiry Publication Board, Ms. Cadario's faculty mentor Professor Tracy Murray wrote:

> I have been working with Ms. Cadario for several months and I am extremely impressed with her dedication and originality. She is from Bolivia and majoring in international business, so her interest in an FTAA seems natural. Nevertheless, she chose the topic without input from me. Further, she recognized that estimating the trade effects for all countries in the hemisphere would be a bigger task than she could accomplish under the time constraints of an honors thesis. She decided to limit her inquiry to Brazil, which is the biggest economy in the region and more populous that the rest of South America combined. She carefully analyzed the likely trade effects on her own. At this point, I suggested the estimation techniques that might be useful. She now has the required data on trade flows between Brazil and the US; her analysis will be extremely detailed and based on actual trade flows of those products of export interest to Brazil.
>
> She also recognized from the beginning that the effects of a FTAA would depend upon the pre-FTAA trading environment. Currently, the US has free trade agreements with Canada and Mexico (NAFTA) and four other countries. The US has several preferential trading arrangements that already provide duty-free access to the US market. Thus, the FTAA is an additional trade policy initiative, which adds to the complexity of estimating the likely trade effects. In her preliminary reading she reviewed the rules and regulations of NAFTA that are likely to serve as a model for the FTAA. She noted that the NAFTA rules of origin add additional complexities that must be taking into consideration. Finally, upon identifying the major products of export interest she noted some special cases, namely sugar, orange juice, and textiles and apparel that again must be studied in some additional detail.
>
> The rigor of her analysis and use of research methodologies would be impressive for a graduate thesis. It is doubly so as an undergraduate honors thesis

# A FREE TRADE AGREEMENT OF THE AMERICAS:

# A CASE STUDY OF BRAZIL

By Maria Eliana Cadario
Department of Economics

Faculty Mentor: Dr. Tracy Murray
Phillips Petroleum Distinguished Professor of Economics

Abstract:

This paper will examine the likely impacts of the proposed Free Trade Agreement of the Americas (FTAA) that was initiated by President Bush in 1994 and is anticipated to include 34 countries in the Western Hemisphere excluding Cuba and to come into force during 2005.
The paper will focus on the likely trade effects for Brazil, the largest potential member of the FTAA. In the first part, I will review the current trade relations between countries in the Western Hemisphere and the US, including the various bilateral and multilateral agreements such as NAFTA, MERCOSUR, CBI, The Andean Trade Preference Act, etc. Next, the paper will present the special complexities introduced by rules of origin which are inherent in any free trade area.
The methodology used to estimate the trade impacts is presented in section 3. Briefly, the elimination of US tariffs on imports from Brazil will stimulate US imports to the benefit of US consumers and at the expense of US producers and imports from other countries. Standard comparative static analysis will be used for the base estimates. These estimates will be qualified for special situations, namely the US quotas on sugar imports, the extremely high US tariffs on orange juice imports, and the forthcoming change in the world trading environment for textiles and apparel.
The expected results will be that the FTAA will provide significant benefits for Brazil, and by implication, for the other Latin American countries which will also benefit from the FTAA.

## 1. Introduction

This paper will examine the likely impacts of the proposed Free Trade Agreement of the Americas (FTAA) that was initiated by former President Bush in 1994 and is anticipated to include 34 countries in the Western Hemisphere excluding Cuba and to come into force during 2005. The paper will focus on the likely trade effects for Brazil, the largest potential member of the FTAA. In the first part, I will explain what the FTAA is and I will describe the trading arrangements under this agreement. In the second part, I will review the current trade relations between countries in the Western Hemisphere and the US, including the various bilateral and multilateral agreements such as NAFTA, MERCOSUR, CBI, The Andean Trade Preference Act, etc. Next, the paper will present the special complexities introduced by rules of origin that are inherent in any free trade area.

The methodology used to estimate the trade impacts is presented in section 3. Briefly, the elimination of US tariffs on imports from Brazil will stimulate US imports to the benefit of US consumers and at the expense of US producers and imports from other countries. Standard comparative static analysis will be used for the base estimates. There will be calculations of trade creation and trade diversion for the major dutiable products that are currently traded between the US and Brazil. These estimates will be qualified for special situations, namely the US quotas on sugar imports, the extremely high US tariffs on orange juice imports, and the forthcoming change in the world-trading environment for textiles and apparel.

The results are that the FTAA will provide significant benefits for Brazil, and by implication, for the other Latin American countries that will also benefit from the FTAA.

1.1 What is the proposed FFAA?

The Free Trade Agreement of the Americas (FTAA) is a proposed agreement among the economies of34 countries in the Western Hemisphere, from Canada to Chile. This agreement excludes Cuba, The FTAA seeks to eliminate barriers and to increase trade and investment flows. This agreement would eliminate tariffs between FTAA countries within 10 years. It would also eliminate regulatory barriers that restrict trade. The Free Trade Agreement of the Americas is not a new idea that has emerged from recent negotiations. The dream of a unified American Continent reaching from the Article Circle to Tierra de Fuego inspired statesmen and thinkers of both North and South America decades ago. -J/

During 1960s, the Latin American countries began regional integration as a means of accelerating their development. Latin American countries signed multilateral agreements creating some of the trade pacts that bind together the North with the South. Some of these early agreements are: The Central American Common Market (1960), Latin American Free Trade Area (1960) and Andean Pact (1969). After these trade agreements were created, the intraregional trade within Latin America increased, but the economic and political crises that erupted in the 1970's brought regional integration to a standstill.
The decade of the 1980/s was not easy for hemispheric relations. Latin American countries struggled to cope with the worst economic crises since the Great Depression and the United States was dealing with the civil wars in Central America. These years were later designated as the "lost decade" for South and Central America because of the lack of growth due to the negative effects of the debt crisis. Nascent democracies in Argentina and Brazil were hit by hyperinflation. Civil strife burdened societies throughout Central and South America.

During the past decade, Latin American countries have improved considerably. These countries have implemented development strategies that combined macroeconomic stabilization policies with increased trade and regulatory reform. Privatization programs have reinvented important sectors, especially transport and utilities. New capital, technology and management skills have been introduced. Another factor that has helped these countries has been the provision of substantial funds to both pay debt and increase infrastructure investments. The objective behind this strategy was to encourage investment from both domestic and foreign sources to stimulate economic growth. As a result, international competition for investment funds has pressured governments in Latin America to accelerate their reforms. Faster growth in these economies created new opportunities for trade and investment. Domestic economic reforms continue to propel the integration process in the Western Hemisphere.

At the same time, regional integration arrangements have evolved and economic and political ties have solidified between countries in South America, Central American and Caribbean communities. These regions have established custom unions among the partner countries and they are also expanding their trade ties with countries in other regions in the Hemisphere. The agreements that have been developed range from simple tariff reduction pacts to comprehensive free trade agreements and custom unions. For example, MERCOSUR, the Southern Cone Common Market (Argentina, Brazil, Paraguay and Uruguay) is strengthening its custom union and has entered into free trade negotiations with Chile, Bolivia and other countries in the Andean Community. In addition, Mexico and Canada have concluded free trade pacts with Chile and Costa Rica; Mexico has agreements with other Central American neighbors, Bolivia, Colombia and Venezuela. Recently (2002), Chile has signed a free trade agreement with the United States. These countries must now adapt quickly to changing conditions in the world markets in order to gain market share and investment funds. Countries cannot use protection barriers to safeguard their industries from foreign competition. Countries must use their regional pacts to reinforce domestic reforms and to prepare themselves to compete effectively against foreign firms at home and abroad.

After acknowledging these pros from economies integration, the Free Trade Agreement of the Americas was launched by many representatives of the hemispheric countries. This FTAA platform comes from the initiative of the North American Free Trade Agreement (NAFTA) and the Enterprise for the Americas Initiative (EAI). NAFTA was the first reciprocal free trade agreement to link a developing country as an equal partner with developed countries. The EAI was the first initiative to link trade, investment and debt issues in a coordinated approach to economic development in Latin America. The creation of the EAI came from two concerns that the United States had about the Latin American countries. First, Latin American countries needed new inflows of foreign capital because their debt problem was not going to be solved without prolonged economic stagnation. Second, the economic and political reforms in this region would not be possible without accelerated growth. The United States concluded 14 agreements on trade and investment with hemispheric countries in 1990-1991. These agreements were the foundation for later negotiations of more comprehensive pacts such as NAFTA. NAFTA was born from the recognition that closer ties with neighbor countries can create great opportunities. NAFTA held the argument that it was going to benefit not only economic growth but also some political issues such as promoting democracy in Mexico and contributing to a long-term solution to immigration problems.

In December of 1994, the United States offered to host the Summit of the Americas in Miami. The Presidents of the Americas met to set a new path in the relations among Western Hemispheric countries. Although the Summit addressed several issues, trade and integration were the centerpiece and the Free Trade Agreement of the Americas was proposed. The Miami Summit initiated a detailed work program to prepare for the negotiations of the FTAA. The Declaration of Principles was: "Although faced with differing development challenges, the Americas are united in pursuing prosperity through open markets, hemispheric integration and sustainable development." The 34 presidents committed their governments to begin the construction of the Free Trade Area of the Americas. The representatives set 2005 as the deadline for the conclusion of negotiations. In March 1998, the FTAA negotiations were finalized in the San Jos6 Declaration of trade minister. The following month, the summit leaders reconvened in Santiago, Chile and officially launched the hemispheric trade negotiations. The Santiago Summit set the agenda for the FTAA. There were twelve negotiating groups at first. They were created to address market access and a consultative group on small economies was developed to ensure that the concerns of the majority of the FTAA countries were reflected in the work of each group. Responsibility for the organization of the FTAA process was given to the Minister of Trade (the United States) while the Vice Ministers of Trade were accountable for managing the preparatory process. This process consisted initially of meetings of trade ministers called Trade Ministerials (the first one in Denver 1995 and the most recent in Quito, Ecuador November 2002). The objectives of these meetings were to define the issues to be addressed in the negotiations and recommend to the presidents when the official negotiations of the FTAA might begin. The negotiations began in Miami in 1998. The talks were set up so that the big and small, the rich and the poor countries would share the responsibility to carry on the negotiations. The United States and Brazil were assigned the responsibility to co-chair the final stage of the negotiations from November 2002 to the end of the talks.

The Declaration of San Jose drafted the objectives and terms under which the FTAA negotiations need to be conducted. These objectives are:

- To promote prosperity through increased integration and free trade
- Establish a Free Trade Area that eliminates barriers to trade gradually, in areas of goods, services and investments no later than 2005
- Market openness Incentive integration of the smaller economies into the FTAA
- Make trade liberalization and environmental policies mutually supportive
- Secure protection of worker rights

There are also certain principles that guide the negotiations among partner countries in this agreement:

- Decisions are made by consensus, so each country has veto power
- Transparency

- Consistency with rules and regulations of the World Trade Organization
- Commitment to improve on WTO rules and disciplines
- Single understanding with simultaneous negotiations in all areas ("nothing is agreed until all is agreed")
- Coexistence of the FTAA with bilateral and sub-regional agreements
- Countries negotiate and take responsibility factions individually or as members of sub regional groups
- Special attention to smaller economies and difference in levels of development
- Rights and obligations shared by all members
- Countries need to make sure that the national laws conform to FTAA obligations

The main purpose of the FTAA is to promote growth and prosperity of the member countries by eliminating barriers to trade and investment. It is clear that that the FTAA will not exist as a final agreement until each issue has been negotiated with the approval of the 34 countries. The FTAA negotiations cover three main areas: market access reforms, including liberalization of trade barriers and removal of discrimination against foreign suppliers in the application of domestic law; rules covering trade and investment in goods and services sectors; and trade facilitation measures.

The twelve original working groups of the preparatory stage became nine Negotiating Groups, a Consultative Group and two special committees for the FTAA negotiations. Each has a Chair and Vice Chair. These positions rotate to obtain geographic balance. The nine groups are divided in areas of main interest:

1. Market access issues for goods
2. Agriculture
3. Services
4. Intellectual property rights
5. Subsidies, antidumping and countervailing duties
6. Government procurement
7. Investment
8. Competition policy
9. Dispute settlement

The other advisory committees were created to deal with (a) problems that arise from the participation of small economics, (b) inputs from representatives of civil society and (c) Internet use and difficulties presented in electronic commerce in the hemisphere. There is also the Administrative Secretariat that supports the negotiations. It provides logistic and administrative services; translating and interpreting services and managing the official documents. The Inter-American Development Bank (IDB), Organization of American States (OAS) and the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) compose the Tripartite Committee. This committee provides technical support and its participation during the preparatory stages has been crucial. As mentioned above the nine negotiating groups are the main keys to achieve effective negotiation in this agreement.

1.2 Market Access (Colombia and Bolivia)

This is the most important negotiating group because the opening of markets is the key to any free trade area agreement. The FTAA include economics of all sizes and shapes and this creates differences among them. These differences between developed and developing countries are the centerpiece of negotiations in this group. They have to negotiate the progressive elimination offal tariff and non-tariff barriers with no exceptions. This group also is required to facilitate integration of the smaller economies and their full participation in the negotiations. This group has addressed issues concerning rules of origin, customs procedures, technical barriers and the creation of hemispheric trade database.

1.3 Agriculture (Argentina and El Salvador)

Agriculture has always been resistant to trade liberalization. The Uruguay Round of global trade talks made some improvements in opening trade in agricultural commodities, but it is still highly protected in much of the world including the United States. The objective of this group is to apply the market access concepts to agriculture and to make sure that sanitary and phytosanitary measures are applied properly, to eliminate export subsidies and to identify other practices that affect the trade of agricultural products.

1.4 Services (Nicaragua and Barbados)

The objective for this group is to establish guidelines to gradually liberalize trade in services. This group has identified six issues that create most of the difficulties in trading services: sector coverage, most favored nation treatment, national treatment, market access, denial of benefits and transparency.

1.5 Intellectual Property Rights (Venezuela and Ecuador)

This area has always been controversial because of the difference in technological advance between developed and developing countries. The development of biotechnology and genetic engineering has complicated even more the challenge of creating acceptable standards. The objective of the FTAA is to make sure that there is adequate protection to intellectual property rights taking into account the changes in technology.

1.6 Subsidies, Antidumping and Countervailing Duties

This group deals with the protection that governments grant to their domestic producers in order to protect their economics from unfair trade practices. This protection given by governments can also be non-tariff barriers to freer trade. It is the objective of the FTAA to improve the application of trade remedy laws.

1.7 Government Procurement (United States and Honduras)

In general government purchases are not covered by multilateral trade pacts but the FTAA will try to expand the access of its markets to government procurement. The objective is to open the procurement process to suppliers from all countries and make it transparent to ensure nondiscrimination among countries, and to create an impartial review process for resolution of complaints.

1.8 Investment (Costa Rica and the Dominican Republic)

Foreign investment is as important in international trade as trade in goods and services. Foreign investment is crucial for international relations and the development of national economies. The controversy in this area is that large foreign firms represent a threat to national sovereignty. The objective of the FTAA is to create a fair and transparent legal framework to promote investment that protects the investor and the investment.

1.9 Competition Policy (Peru and Trinidad and Toba2o)

The objective of this group is to create laws that the domestic governments can use to prevent monopolies. Liberalization of trade should not include the practice of excessive market power exercised by some firms.

1.10 Dispute Settlement (Chile, Uruguay and Paraguay)

The objective of this group is to establish a transparent, fair and effective process for dispute settlement among the FTAA countries. The WTO has such a mechanism.

In addition to the nine negotiating groups that were mentioned above, there are three additional groups that deal with small economies, civil society participation in the FTAA process and electronic commerce in hemispheric trade.

1.11 Consultative Group: Smaller Economies (Jamaica and Guatemala)

The 34 countries that will be members of the proposed FTAA are very diverse in terms of size and level of development. This group tries to create a way to protect and fully integrate the smaller economics of Central America into the agreement without having too many exemptions. This group is in charge of negotiating issues in the interest of these small countries.

1.12 Committee of Government Representatives on Civil Society (Canada and Argentina)

The objective of this group is to introduce representatives of organized labor and environmental groups inside the FTAA negotiating process. This concern is addressed in order to comply with the principle of transparency mentioned in the first part of this review. The FTAA recognizes that it is important to have the participation of the different sectors of society in this process. The committee receives input from civilians and it is transmitted to the Trade Ministers.

1.13 Committee of Experts on Electronic Commerce (Barbados)

This committee makes recommendations about the fast expansion of Internet usage and electronic commerce throughout the Western Hemisphere.

In Quito, Ecuador in November 1, 2002, the trade ministers set the final stage for the FTAA negotiations. This was the 7th Ministerial Meeting of the Free Trade Area of the Americas. The FTAA is a free trade area in which each country can ship their goods to other FTAA countries without tariffs. However, each FTAA country can set their own tariffs for non-FTAA members. For example, if Brazil imports car engines from the United States, these products will eventually have zero tariff and they will enter Brazil free of duties. On the other hand, if Brazil imports car engines from Japan and these products have a tariff rate of 10%, the Japanese exporter will be discriminated against because his/her car engine is more expensive to the Brazilian importer than is the US car engine. Even though in this exercise, the tariff rates between Brazil and the United States will be assumed to be zero, it is important to recognize that in reality, the tariffs among FTAA countries will be reduced progressively of 10 years. The FTAA will be a unique trade bloc with different factors of endowment and different production capabilities.

1.14 Trade Promotion Authority (TPA)

Before going further, it is crucial to understand that during the actual administration of the United States, the House and the Senate have voted to pass final legislation that provides President Bush with trade promotion authority ("fast-track"), ending a long dispute over the economic, labor and environmental impacts of granting this power to the executive branch. This bill limits lawmakers to an up or down vote on free trade deals that are worked out by the White House through 2005. The lack of this authority in the past has hurt US ability to negotiate the best access for exports. With the introduction of this new bill, the United States, that is the biggest player in this negotiation together with Brazil, will be able to create concrete opportunities for the other countries that will be part of the Free Trade Agreement of the Americas.

In order to be more specific, the TPA is a trade-negotiating tool and it helps the President of the United States and Congress to develop trade policy. Congress defines the objectives that the US negotiators should look for and requires the Administration to consult with Congress at every step of the negotiations. Once an agreement is brought to Congress, they can review it but they cannot amend it.

2. Current bilateral and multilateral Agreements in the Western Hemisphere

It is important to emphasize that the FTAA will not be a substitute for the current regional arrangements in the hemisphere. Those pacts will coexist and complement the hemispheric agreement. The readiness of Latin America and the Caribbean countries depends on the reforms that those regional agreements undertake. It is necessary to have success in those "small-scale" trade pacts to ensure that the FTAA will be successful too. Regional trading rules may be changed to comply with hemispheric-wide standards but in other cases when regional trade rules go beyond those in the FTAA, the regional rules would not change.

2.1 North American Free Trade Agreement (NAFTA)

The members of this agreement are Canada, Mexico and the United States. It is a free trade area of 387 million people. The total intragroup trade is $437.8 billion. US imports from Canada and Mexico are $230.2 billion. Exports to the US equal 83% of total Canadian and Mexican exports. NAFTA came into effect in January 1994. This agreement was created to promote free trade in goods and services and increase investment. After the US-Canada agreement, NAFTA has tried to improve government procurement, intellectual property and investor rights and it has created more stringent rules of origin. NAFTA also eliminates non-tariff barriers such as import licenses and, guarantees fair and open competition. Unlike MERCOSUR or the ANDEAN Pact, NAFTA does not have a common external tariff to nonmembers. NATTA has improved the trade relations among the member countries. The main trading partner of the United States is Canada. Mexico is also getting benefits out of this deal, by exporting more goods into the US at cheaper prices than before. According to the Council of the Americas, the trade of the US with Mexico and Canada accounts for one-third of all US merchandise trade and it exceeds the trade that the US has with Europe and Japan. As a result of NAFTA, US accounts for 76% of Canadian imports and 74% of Mexican imports. Mexican products have also entered the US market strongly and these effects contribute to the focus of the US to expand trade with Latin America.

2.2 Caribbean Community and Common Market (CARICOM)

The members of this custom union are Antigua & Barbuda, Bahamas, Barbados, Belize, Dominica, Guyana, Jamaica, Montserrat, St. Kitts & Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago. The representative market is of 6 million people. This agreement came into effect in August 1, 1973. The objective of this agreement was the eventual integration of its members and economies, and the creation of a common market. CARICOM has never been effectively completed. A fully implemented common market would significantly enhance the market potential of these countries. For CARICOM, a hemispheric agreement can provide stronger trade relations and investment links with North and South America to further expand their economies. Even tough CARICOM countries do not account for a large portion of the industrialized countries trade; these small countries could improve its trade volume and expand economically. One of their problems is that members have similar export products and similar economies (bananas, hotel occupancy, tourism, fishery, etc).

2.3 Caribbean Basin Initiative (CBI)

The members of this agreement are Antigua and Barbuda, Aruba, Bahamas, Belize, British Virgin Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago, and the United States. This is a preferential trade arrangement. CBI imports from the US is $14.2 billion 29% of total imports; US imports from CBI countries is $14.7 billion. Exports to the US equal 36% of total CBI country exports. The objective of this agreement is to revitalize the economies of the Caribbean countries through tariff preferences. CBI was established in 198 US eliminated duties on al products except textile and apparel products, canned tuna, footwear, certain leather good and certain watches and watch parts.

2.4 US- Andean Trade Preference Act (ATPA)

The members of this agreement are Bolivia, Colombia, Ecuador, Peru and the United States. The ATPA has a common external tariff. There is a representative market of 103 million people. It was implemented in May 1988. The objective of this agreement is to establish a free trade area with a common external tariff and eventually become a full common market. Another objective is to expand economic alternatives for Andean countries and to combat drug production and trafficking. The United States is the main export partner for the

 

Andean Pact countries. This has become a fast growing market for US exports too. The Andean Pact has a common external tariff (CET) ranging from 5, 10, 15 and 20 percent. The Andean group has intended negotiations with MERCOSUR to create a free trade area that joins together the two trading blocs. It would take some more time to agree to a free trade area among these countries since a study done by the Inter-American Institute for Cooperation on Agriculture found that the agricultural conditions among countries of ATRA and MERCOSUR are largely different.

2.5 Southern Cone Common Market- Mercado Comun del Sur (MERCOSUR) or Mercado Comun do Sul (MERCOSUL)

This is probably the most important agreement that involves countries in Latin America. The members are Argentina, Brazil, Paraguay and Uruguay. Bolivia and Chile are associate partners. It is a custom union with a representative market of 200 million people. It came into effect in January 1995. The objective of MERCOSUR is to establish a common market in the south that is expected to be fully implemented at an unspecified date. MERCOSUR has a combined GDP of $ 1 trillion (approximately two thirds of the GDP of South America). MERCOSUR imports from the US $ 18.8 billion, 22% of total imports, US imports from MERCOSUR is $ 11.4 billion. Exports to the US equal 15% of total MERCOSUR exports. All tariffs will be eliminated and MERCOSUR members will fully integrate with a common external tariff schedule. The maximum tariff rate will be 20%, with an average tariff rate at 10%. Individual national rates apply to imports of capital and high-technology goods until next decade when capital goods receive a CET of 14%. In 2006, a CET of 16% will be applied to informatics and telecommunications. Chile signed a free trade agreement with MERCOSUR in October 1996 and Bolivia did the same in March 1997.

The trade relationships with the US started in early 1990's with talks about trade and investment framework agreements. MERCOSUR started better than expected because of the economic reforms undertaken by the two biggest players: Argentina and Brazil. In the 1990's, both countries ended their hyperinflation. Programs of privatization also fueled an increase in foreign investment in these two countries. However, the recent economic crisis in Argentina ha put MERCOSUR in a standstill situation. In order to sustain economic growth, the countries of MERCOSUR will have to integrate their markets even more by improving transportation links, speed up custom processes and sustain macroeconomic stability. With the potential for growth and economic benefit, MERCOSUR represents an important trading bloc for the FTAA. Brazil's trade with the US is primarily in manufactures while other countries seek reform of agricultural trade barriers and subsidies. According to Brazil's ambassador to the United States, in the year 2000, Brazil had a weak performance in exports to the United States because of discriminatory treatment due to NAFTA, competition from the rest of the world, and US import restrictions. For Brazil, the FTAA represents good opportunities for Brazilian textiles, clothing, footwear, citrus products, sugar, etc. To the extent that the FTAA will help these Latin American countries recover from their economic and growth stagnation, it will strongly serve Brazilian and MERCOSUR trade interests.

2.6 Other Free Trade agreements amon2 countries in the Western Hemisphere

There are other free trade agreements that are worthy to mention. There is the Chile MERCOSUR free trade agreement in which the members of MERCOSUR have a free trade arrangement with Chile. The objective of this agreement is to maintain and expand preferential tariff arrangements between Chile and MERCOSUR. This agreement went into effect in October 1996. Chilean imports from the MERCOSUR were $4.5 billion (16% of total imports); MERCOSUR imports from Chile were $1.7 billion (2% of total imports).

Another free trade area is the one formed by Chile and Mexico in September 1991. The objective of this agreement is to promote bilateral trade and investment flows. The other objectives included the elimination of tariffs on 90% of the traded goods, tariffs phased out in synthetic textiles, glass, ceramics, meat, poultry, eggs and some timber products. The tariffs on vehicles should be reduced and there should be harmonization in tax and investment rules. Although this agreement went into effect in 1992, tariffs on nearly all products were gradually reduced and eliminated in 1996. Tariffs on more than 100 products were abolished by 1998. However, there are products that are excluded from tariff cuts such as sugar, tobacco, and petroleum products.

The most recent Free Trade Agreement was signed between the US and Chile (2002). This pact says that tariffs and quotas on all goods should be abolished after the transition period with no exemptions. With this agreement, about 85% of the trade in consumer and industrial goods becomes duty-free when the agreement is signed. The remaining tariffs will be eliminated within four years after the agreement in implemented. The US exports that will gain free access to the Chilean market arc: agricultural and construction equipment, auto and auto parts, computers, technology products, medical equipment and paper products. Textiles and apparel will have zero tariffs if they meet the rules of origin agreed in the pact. This agreement is definitely an open door to the conclusion of the FTAA by the specified date. This agreement is a comprehensive one that includes trade in services such as banks, insurance, securities and related firms, open telecommunication market, open investment flows, high level of intellectual property protection, protection against anti-competitive and monopolistic behavior, dispute settlement, etc. In general, the structure of the Chile-US free trade agreement is similar if not equal to the proposed structure of the FTAA. This agreement covers all the relevant areas that need attention and it definitely can be used as a model to start the FTAA agreement.

2.7 Special Problems: Rules of Origin in the FTAA

$$RVC = \frac{TV - VNM}{TV} \times 100$$

When countries join a Free Trade Area, there are complex rules of origin that are part of the agreement. In a free trade area, the member countries will have zero tariffs among themselves. However, every country can keep its own tariff rates for non-members. Rules of origins were created to prevent a non-member from exporting a product to a low tariff member and then re-exporting the product to a high tariff member without paying the higher tariff. The rules of origin determine whether goods qualify for preferential tariff treatment. Products that are wholly made from material produced in the FTA qualify for free trade. Products imported from non-members do not. Products containing some materials imported from non-members may or may not qualify for free trade. This will depend upon the rules of origin. These rules that should be created for the FTAA will probably be based on the existing ones in NAFTA. In any instance, rules of origin represent a set of requirements that are based on three conditions that need to be met in order to have goods exported under free trade area agreement (Murray, 84):

1. The products should be shipped from the FTAA member country to the other FTAA member without intermediate trade or processing.
2. The products that are being traded need to have appropriate documents that certify that they qualify for preferential tariff treatment under the agreement.
3. The exporting country should have made a minimum processing in the products being traded.

For condition 1, there is an exception when the exporting country is land-locked (Bolivia and

Paraguay). In these cases, the products can be in kept in third countries only under the condition of being in transit. Although this is an exception to rules of origin, it becomes complex when there is a free trade area agreement. The rules of origin in NAFTA ensures that free trade benefits are given to firms and individuals who produce or manufacture good in North America using local input materials and labor. NAFTA has agreed to implement many uniform customs procedures and regulations in the three countries that are members. This uniformity in the procedures facilitate the exporting process because it saves transaction costs to the small and medium sized companies that exports to the different NAFTA countries. In addition, the documentation pertaining to rules of origin, records keeping and origin verifications are the same for all three NAFTA countries. In the case of the FTAA this can be a potential problem since there are 34 countries involved in the agreement. In addition, there are different languages spoken in the countries: Spanish, English, French, and Portuguese. NAFTA uses a formula in order to calculate the local value content of the good that is being imported to the member country. The exporter or the producer of the good can choose the transaction value method or the net cost method to calculate this content.

The transaction value method is:



$$RVC = \frac{TV - VNM}{TV} \times 100$$

where,

RVC is the regional value content, expressed as a percentage.

TV is the transaction value of the good adjusted to a F.O.B

basis

VNM is the value of non-originating materials used by the producer in the production of the good.

The net cost method is:

$$RVC = \frac{TV - VNM}{TV} \times 100$$

where

RVC is the regional value content, expressed as a

percentage; NC is the net cost of the good; and

VNM is the value of non-originating (imported) materials used by the producer in the production of the good.

Under NAFTA, a product is said to originate in the free trade area when it grows, is harvested, wholly produced, or substantially transformed in the free trade area. When substantial transformation is the case, then the process causes a product to shift from one tariff classification to another. The term substantially transformed still in controversy sometimes. For products to qualify for free trade there should be a limit on the use of imported inputs when processing the good. This has the objective of having the value of the imported inputs not to exceed a certain percentage of the export value of the final good. Rules of origin should be used for the only purpose of avoiding the "free rider" problem. Generally, rules of origin can be used as a non-tariff barrier to protect domestic industries. With regard to the FTAA rules of origin, there is a need to establish a uniform system for FTAA rules to make the trade process less complex. The system would need clear, transparent and symmetric rules of origin to avoid confusion.

3. My proposed analysis: Brazil and United States

In this analysis, the main focus will be the relationships between The United States and Brazil because of their mutual relevance in the negotiation of the FTAA. It is important to mention that Latin America has a diverse set of economies, social and political structures. The effects of this free trade area will mainly depend on the individual country. However, the purpose of this thesis is to evaluate the effects that this free trade agreement will have on the trade patterns between Brazil and the United States. The effects that will be presented will be from the perspective of consumers, producers, rest of the world and NAFTA. According to the thesis that will be exposed, Brazil and other Latin American countries will be the main beneficiaries of this free trade area. In general, consumers will benefit, domestic producers will lose and the imports from countries outside the free trade area will decrease as well. In this analysis, there will potentially be trade diversion and trade creation between these country players and this will be discussed in the later section of this project. Brazil will be generally mentioned as the exporting country and the United States as the importing country.

3.1 Trade Creation and Trade Diversion

Two of the main incentives produced by a free trade area like the FTAA are: trade creation and trade diversion. We will assume for analytical purposes that the FTAA reduction of tariffs in Brazilian products and US products will become effective immediately after the agreement is signed. This move toward integration and free trade for the hemisphere is occurring against an extraordinary environment in which advanced economies are merging with developing nations. In this case, the United States represents the industrialized nation and Brazil represents the developing nation. Although Brazil is considered an agrarian economy still, it has moved along way in the past decade. Brazil is the dominant member of the MERCOSUR accounting for approximately 70% of the total GDP, about 80% of its population and two thirds of its total trade. (IDB-Intal 2000, Schott). Brazil has contributed to the region outgrowth because of investment in important transportation and telecommunications infrastructure and in energy sources. Brazilian exports are gaining an ever-increasing share of the world markets for manufactured goods. Brazil is the world's largest producer and exporter of coffee but coffee exports account for only 5% of total exports. Brazil's largest single trade partner is the United States. The United States imports a wide range of products from Brazil, from orange juice concentrate to automotive parts, shoes, textile, airplanes, etc.

When the FTAA takes effect, there will be trade effects. lf we analyze this from the prospect of Brazilian welfare, we can say that the FTAA will eliminate the tariff rates and as a result, the United States will import more from Brazil increasing US consumption, displacing domestic production, displacing imports from the rest of the world and displacing imports from NAFTA. This will be the general impact that applies to all products whether they are final goods or input materials. Other Latin American countries will also share this effect because they will also be part of the FTAA. Of course, it is important to note that it will depend on the type of product that is being analyzed. There may be cases where Brazil will be the only FTAA country that exports a certain product to the US and in this case, the other Latin American countries will not have any shared effect.

Trade creation (Figure 1) means that the free trade area will create trade between the exporting country and the importing country that would not have existed otherwise. As a result, the supply of goods shifts to a more efficient producer of the good. In all cases, trade creation will raise welfare. In this base scenario, it is necessary to make a distinction between the effects of the trade creation:

1. Positive impact on US buyers of imports. These could be consumers of final goods and firms using input materials.

2. Negative impact on US producers of import-competing products.

3. Negative impact on US imports from NAFTA (Canada, Mexico, Chile)

4. Negative impact on US imports from the rest of the world.

The consumers of the importing country will benefit from the free trade area because of the reduction in the domestic price of both imported good and domestic substitutes, raising consumer surplus. The producers in the importing country will suffer losses as a result of the FTAA. The decrease in the price of their product in the domestic market reduces producer surplus. The price decrease will also cause the decrease in output of existing domestic firms and potentially some firms will shut down. This will have a negative effect on employment and a decrease in profits. As a result of this effect, the domestic producers will have to accommodate to the competition in low cost production. The government of the importing country will suffer a loss of revenue that will be transferred to the exporters of the exporting country. It is important to realize that when the FTAA becomes a reality, many markets and multiple countries will be affected. In order to analyze the aggregate effects of the FTAA, we would need to sum up the effects across markets.

When the FTAA comes into effect, there will also be another effect that is called Trade Diversion (figure 1). The free trade area will divert trade away from a more efficient supplier outside the FTAA towards a less efficient supplier within the FTAA. The effect of trade diversion can be positive or negative for national welfare and that will depend on how much trade creation is born from the FTAA. To illustrate trade diversion, here is a simple example: assume that the United States was importing plastics from Spain at a cost of $3 per feet plus $1 tariff; the import price is $4. The cost for Brazil is $3.5 per feet. When the US and Brazil form the FTAA, the tariff rate imposed in the Brazilian plastic will be zero and the plastic price will be $3.5 per feet. In this case, there will be trade diversion from the plastic supply from Spain to the plastic supply from Brazil.

The welfare effects of trade diversion are negative. If trade creation is larger than the magnitude of trade diversion, then the net welfare will be positive. On the other hand, if trade creation in smaller than the magnitude of trade diversion, then the net welfare will be negative. Generally stating, the larger the difference between the FTAA country and the rest of the world, the more likely that trade diversion will reduce welfare.

Evaluating the effects of trade creation and trade diversion from the perspective of Brazil, it can be concluded that with the introduction of the FTAA, Brazil's economy will experience what is called a Trade Expansion that benefits Brazilian economy. It is necessary to recognize that there are preferential agreements between the US and Brazil in trade of certain products such as airplanes and coffee. In the case of these products, the FTAA will not have a positive or negative effect on the trade between these two countries. This is also true for other Latin American countries that benefit from free access to the US market. In this case, these other Latin American countries (e.g. Mexico, Chile) are already exporting their products duty-free and the introduction in the FTAA will not cause an increase in the volume of trade with the US. It might even hurt them since the US will be able to import from more suppliers without tariffs.

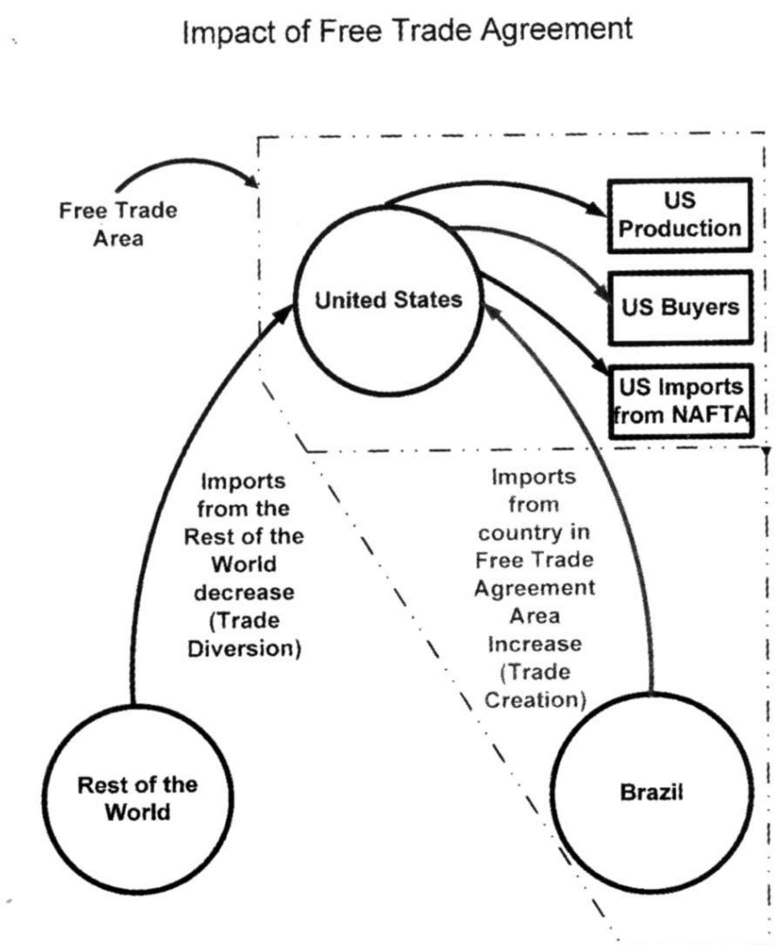


**Figure 1: Incentives created by a free trade area: Trade Creation and Trade Diversion**

3.2 Impact of the FIPAA on Brazil

From the Brazilian perspective, the FTAA could potentially facilitate the access to the US market, lower the costs of inputs and final products, facilitate the transfer of technology and increase the investment flows towards all Latin American countries. The United States has also interests in the FTAA. Among these interests are the stronger economic, political and foreign policy ties with Latin American countries, especially with Brazil. The US is looking forward to the open access to the large Brazilian market of goods, services and capital movements throughout the region. The United States wants also to get the share of the trade that the European Union has conquered in Brazil. The FTAA would put the US in advantageous position vis-à-vis European and Asian companies that are currently doing business in this area. Brazil is an important trade partner of the US. During the 1990's, Brazil implemented market oriented reforms where protectionist policies were replaced by privatization of inefficient government-owned agencies and the liberalization of trade and investment. According to the SECEX (Secretary of Extemal Commerce) of Brazil, in 1999 Brazil's top exports were mainly comprised of natural resource based goods, and manufactured goods only accounted for 27% of Brazil's top ten exports. In the year 2000, the US accounted for 23.9% of Brazilian exports. The European Union accounted for
26.8%, and the rest of Latin America accounted for 23.4%. This indicates that almost 50% of Brazilian exports go to the Americas. With the FTAA, the Brazilian exports will be focused on the US market at the expense of European countries. Brazil is a very attractive trade partner for the US. American companies have been realizing that the opportunities to invest in Brazil are enormous. More than 400 of the Fortune 500 companies currently have operation in Brazil. Brazil has also been identified by the US Department of commerce as one of the ten "strategic partners" of this century.

| | Argentina | Brazil | Mexico | Argentina + Brazil + Mexico | Latin America and Caribbean |
|---|---|---|---|---|---|
| Population (million - 2001) | 37.5 | 172.6 | 99.4 | 309.5 | 523.7 |
| GDP (US$ billion - 2001) | 261 | 502.5 | 617 | 1380.5 | 1,900 |
| FDI (US$ billion - 2000) | 11.7 | 32.8 | 13.3 | 57.8 | 75.1 |

**Source: World Bank - http://www.worldbank.org/data/countrydata/countrydata.html**

Brazil imports have been diversifying throughout the last years. Approximately 49% of the imports are raw materials and 27% are finished goods. The imports of durable goods are led by automobiles that are among the main products imported by Brazil. The trade flow between Brazil and the other members of the MERCOSUR averages 15% of the country's foreign trade flow for the period 1998-2000. (SECEX). In the year 2000, trade with MERCOSUR totaled $15.5 million. Brazil's exports to the MERCOSUR are composed of manufactured goods and the imports from MERCOSUR are mainly transportation material, vegetable and animal origin products, mineral products, textiles, machines, etc.

3.3 Effective Protection Rate (EPR)

A tariff is a form of protection for the domestic industry. If the tariff is an ad valorem tariff proportional to the value of the imports, then the tariff rate itself represents the amount of protection. If the tariff is a specific amount, then in order to measure the amount of protection, the tariff is divided by the price and the result is the ad valorem equivalent. However, sometimes the effect of a tariff can vary in the different stages of production of a good. Most wealthy countries have an escalated tariff schedule with lower tariffs on raw materials, modest tariffs on inputs materials and higher tariffs on final goods. This escalation causes the effective protection that is highest on final goods, lower on intermediate inputs, and lowest on raw materials. Such escalated structure of tariffs alters the composition of imports favoring the importation of raw materials and discourage final goods. Therefore, the value added is moved from the exporting country to the importing country. These effects are difficult to estimate. However, the direction of such is known. By saying this, the FTAA will reverse the escalation in tariff schedules resulting in undoing the bias against trade in final good and the bias in favor of trade in raw materials and intermediate inputs. Therefore, Brazil and the other Latin American countries will be able to export more final goods and increase their income. To illustrate this concept, here is an example:

- Suppose the price of a final good is $10 and the price of the input material is $4. Before any tariff the Value Added is $10 - $4 = $6

- Suppose the US imposes a tariff (T) on the final good of 20%, then the final good price is now $12. The Value Added is $12 - $4 = $8 or ([$8 - $6]/$6) - 33%

- Suppose that the US imposes a tariff (t) on the input material of 20%; then the price of the input material is $4.8. The Value Added is $12 - $4.8 = $7.2 or ([$7.2 - $6]/$6] 20%

- Suppose that now the tariff (t) on the input material is 10%. The price of such would be $4.4. The Value Added is then $12 - $4.4 = $7.6 or ([$7.6 - $6]/$6) = 27%

- Suppose that now the tariff (t) on the input material is 40%. The price of such would be $$5.6. The Value Added is then $12 - $5.6 = $6.4 or ([$6.4 - $61/$6) = 7%

The effective protection rate (EPR) will be greater when the tariff on the final good is greater than the tariff on the input material. When the tariff on the final good is equal to the tariff on the input material, then the effective protection rate will be the same to both.

**If T>t**
**EPR >T**

**If T=t**
**EPR=T=t**

3.4 Trade Creation and Trade Diversion for Dutiable Products from Brazil

The data is based on statistics from 2001. The descriptions of the products in this sample are found in the website of the US International Trade Commission www.usitc.gov, under the Harmonized Tariff Schedule of the United States.

$$TC = E_M \times M_B \times \Delta t^B$$

$$TC = E_M \times DUTY^B$$

$$TD_{NAFTA} = TC \times [M_{total\,/}US] \times M_{NAFTA} / M_{total}$$

$$TD_{ROW} = TC \times [M_{total} / US] \times M_{ROW} / M_{total}$$

**Table 1: Trade Benefits for Brazil from FTAA (2001 $ million)**

| Product | HS Code | TC | TD | TE |
|---|---|---|---|---|
| Footwear | 6402, 6402, 6404 ** | $114.26 | $92.71 | $206.97 |
| Orange Juice, frozen concentrate | 20091100 | $45.50 | $7.37 | $52.87 |
| Tobacco, unmanufactured | 2401 * | $16.78 | $6.79 | $23.57 |
| Ceramic tiles | 6908 *** | $7.98 | $6.63 | $14.61 |
| Cotten linen | 63026000 | $7.20 | $6.28 | $13.48 |
| Cotton trousers | 62046240 | $4.43 | $4.38 | $8.81 |
| Cotton sweaters, knitted | 61102020 | $3.95 | $3.93 | $7.88 |
| Cotton t-shirts, knitted | 61091000 | $3.48 | $3.36 | $6.84 |
| Plywood | 44121430 | $2.49 | $1.26 | $3.75 |
| Ball bearings | 8482 **** | $1.77 | $1.70 | $3.47 |
| Towels | 63029100 | $0.09 | $0.08 | $0.16 |
| Subtotal | | $207.93 | $134.50 | $342.43 |
| Other Dutiable Products | | $80.86 | $52.31 | $133.17 |
| *TOTAL* | | *$288.79* | *$186.81* | *$475.60* |

* HS code 2401 -2083, -2085.
** HS code 6402 - 9140, -9918, 6402 -5960, -5990, -9190, -9920, -9960, -9990, 6404 -1935, -2040.
***HS code 6908 -1050, -9000.
****HS code 8482 -1050, -2000, -9915.

The total value of US imports of sample product from Brazil for 2001 was $1,613 millions. There were a total of dutiable products of$4,981. We can conclude that 32% of US dutiable imports from Brazil come from this group of products. (See Appendix).

$$\Sigma TC_B = \$288.79 \text{ millions}$$
$$\$207/\$288.79 = 72\% \text{ (tariff revenue)}$$
$$\Sigma TD = \$186.81 \text{ millions}$$
$$\Sigma TE_B = \$475.60 \text{ millions}$$

I conclude that this sample of products contain about 32.4% of all the products that US imports from Brazil. However, these products account for 72% of the duties collected. In the year 2001, the total tariff revenue collected from Brazilian imports was $287.97 millions and the sample products accounted for $288.79 millions per year. Clearly, this sample represents the most significant group of products that will benefit from the FTAA. The resting 68% of products that come to the US from Brazil are not representative in dollars volume or they enter the country with preferential treatment already. Based on this group of significant products, I have also calculated trade creation for Brazil, trade diversion for NAFTA and the rest of the world and finally trade expansion for Brazil. When calculating trade creation:

$$TC = E_M \times M_B \times \Delta t^B$$
$$TC = E_M \times DUTY^B$$

The assumption of these calculations is that the elasticity of imports from Brazil (E~) is 1.

$$TC_B = \$288.79 \text{ millions}$$

Trade diversion for NAFTA and the rest of the world has also been calculated:

$$TD_{NAFTA} = TC \times [M_{total} / US] \times M_{NAFTA} / M_{total}$$

$$TD_{ROW} = TC \times [M_{total} / US] \times M_{ROW} / M_{total}$$

$$M_{total} = M_{NAFTA} + M_{ROW} + M_{BRAZIL}$$

For this trade diversion, the assumption is that $M_{TOTAL}$ / US is 1. The exact number was not available and that is why it is being considered a unit. This is also based with statistics from 2001. The products that are mainly traded between the US and Brazil are not going to hurt the trade with NAFTA in a significant manner because there is not a significant volume of trade in these products between NAFTA and US. However, one of the products that the US trade with NAFTA is orange juice and this is probably one of the products that will largely benefit Brazil with the FTAA. The trade diversion for NAFTA in orange juice is $7.4 millions per year. However there may be an underestimation since Brazil can potentially take over all of the imports of orange juice in the US. Trade diversion as a total for NAFTA is $7.9821 millions and most of it is taken by orange juice. Trade diversion for the rest of the world is $1134.5 millions. Brazil will probably pick up on this amount of trade from other countries like in Europe. US producers will most likely not benefit from this because of cheaper imports to the US. US consumers will have access to a broader range of products at cheaper prices as a result of the abolition of import tariffs for Latin America. Trade expansion for Brazil has been calculated to be $459.58 millions that include products that were not taken into account in the sample (the remaining 28%).

By multiplying the sum of total trade expansions calculated in the sample by one-third, I am accounting for other products that are not in this sample and also for possible errors. When I calculate trade diversion, I excluded the data for other Latin American countries because the FTAA will include them and they will get the same import treatment (0 tariffs) as Brazil. The benefits that Brazil will get with this agreement will be shared with other Latin American countries.

It is important to acknowledge that Brazil exports textiles and apparel to the US and they have a large potential of increasing these exports. However, there may be another factor affecting Brazil's potential in this industry. According to the Uruguay Round and the Multifibre Arrangement (MFA), the quotas on textiles and apparel will be completely eliminated for China by 2005. China has a competitive advantage in this industry and Chinese exports of textiles to the US will grow dramatically when the quotas completely phase out in 2005. Brazil will be able to export textiles but not as much as estimated. As a result of this, Brazil will have to take action in the footwear industry, where they have a competitive advantage. Footwear exports have the potential to grow exponentially after the FTAA. The calculation of trade creation for Brazilian footwear is $114.3. This number is underestimated because Brazil's capacity in manufacturing shoes. This accounts for ($114.26/$207.45) = 55% of the total trade creation calculated for Brazil.

### 3.5 Special Cases

#### 3.5a Sugar

Sugar is an important product for both Brazil and the US. However, the US has always been very protective with the imports of sugar. Sugar has suffered quantitative restrictions, duties, and fee on imports. Brazil is a world leader producer of sugar. They have a huge capacity of production and without discussion sugar has always been one of the major export products for Brazil. This is the reason why Brazilian sugar is taking a considerable importance in the negotiations of the FTAA. As one of the largest sugar producers, Brazil has considerable influence over the international sugar market. Brazil exports approximately 100,000 to 200,000 metric tons to the US every year but it has a larger role in the global market. In the year 2000, Brazil exported about 8 million metric tons of raw sugar. Currently, the world price of sugar is about 08.5 per pound while the US price is about 022.5 per pound. Brazil is currently the second largest quota holder to the US market according to the Office of the US Trade Representative. Brazil's quota is 152,691 metric tons for 2003. The total quota that the US has on sugar is 1,117,195 metric tons, which is the minimum level under the Uruguay Round Agreement in 1995. This quota is divided among 40 countries. Based on this information, Brazil could take over the imports of sugar to the US after the quotas are phased out. If the FTAA becomes a true free area, Brazil could become the main exporter of sugar to the US. The other main exporters of sugar are: Australia (87,402), Dominican Republic (185,335), Guatemala (50,546) and Philippines (142,160). Brazil will be able to compete with the Caribbean islands that are large producers of sugar too. The reason to say this is because Brazil has a territory advantage over the islands. Brazil's capacity is much larger than any of these small islands. Another potential competitor that we need to consider in a future is Cuba. Currently, Cuba is excluded from this free trade area. However, when Fidel Castro is not in power anymore, there is the possibility that the trade relationships would be built again with the US and this could make Cuba a potential exporter of sugar. A factor to consider in this industry and the imports that come to the US is that the other competitors are the Caribbean Islands. However, these economies are probably producing at their maximum capacity and currently they receive a price four times larger than the world price when they export to the US. When the FTAA is signed, these islands may even be hurt because of the fact that the US will pay world prices for sugar imports.

3.5b Orange Juice

Citrus products are an important negotiation area in the FTAA. Intheyear200I,theUS imported $75 millions in orange juice from Brazil. The tariff rate on this product is about 61.1% and the reason for it to be so high is because the US has history of protecting the US production of orange juice, especially in Florida. Orange juice trade between the US and Latin America is mostly in one direction with the US importing from Brazil, Mexico, Honduras and Costa Rica. Brazil imports account for about 60% of total orange juice imports. Brazilian orange juice supplements Florida's production. During 1996-1998, Florida decreased its orange production but recently there has been an increase in the state's output. With the removal of tariffs, there may be an incentive to import more inexpensive Brazilian orange juice, which will potentially displace Florida's juice. The higher cost of production in the US will probably keep Florida's prices above Brazil's. Therefore, there will be an increase in the demand for imported orange juice. Since the tariff on Brazilian orange juice is currently so high, the estimation that has been done for this specific product may be underestimated. The real results will only be measured when the FTAA be fully implemented.

In this analysis, I am not estimating any investment effects, any Brazilian imports from the US or any Brazilian trade with other Latin American countries. These calculations would have to take more complex processes. However, it is well known that FTAs create incentives for foreign direct investment (FDI) as well as domestic investment. There are two incentives that are important:

> I. There are several firms in the US that will have an incentive to invest in productive capacity in Brazil designed to increase production to serve the Brazilian and US markets.
>
> 2. Countries that are non-members of the FTAA (EU, Japan, etc) will have similar incentives to invest in productive capacity in Brazil. Since exports from their home countries do not have the preferential treatment that the FTAA countries will face, these outside countries will have an incentive to invest in FTAA members. These effects are complex to estimate.

## 4. Conclusion

After analyzing the process in which the FTAA is taking place and the potential effects that this will have in the trade between Brazil and the US, my conclusion is that the FTAA will have potential gains for countries that are in the process of development such as Brazil. The poorer countries are the ones who will benefit the most because of the innovative technology and the open access to advanced markets like the US. Brazil in this case, is taking the majority of the benefits from the FTAA. Brazilian producers will benefit because they will be able to export more to the US, especially in the cases of sugar, orange juice and footwear. US producers will potentially suffer losses because of the introduction of more competitive raw materials, intermediate inputs and final goods. The FTAA will undo the escalation of tariff schedules that the US have on finals goods and raw materials. This will give the industries of final goods in Brazil the incentive to export higher volumes of goods to the US. US producers will have to adjust to competitive prices and quality such as orange juice. The cost of production and labor in the US are higher than in other countries and this is a controversy because of labor standards that should be implemented in all countries. However, the fact is that the lowest cost is in Brazil and this will force US producers to catch up in the competitive way of producing output. Because of the FTAA, there will be trade diversion for goods coming from NAFTA and the rest of the world. Based on the findings from the sample of products used to calculate trade creation, trade diversion and trade expansion, the conclusion is that trade diversion will mostly hurt the rest of the countries that are not NAFTA or FTAA members. The majority of the products that Brazil exports to the US are mainly exported by non-NAFTA members. The numbers that came out of the calculations may be underestimated in cases such as sugar, orange juice, tobacco and footwear. On the other hand, calculations for the textile and apparel industry are overestimated because of the elimination of quotas that will take place in 2005 for China. Brazil will have a trade expansion of$459.58 millions and this number is below what may happen when the free trade area comes into effect.

All these benefits will also be shared with other FTAA beneficiaries that are active exporters to the US. It is important to also consider the probability that after the FTAA is implemented, the political, social and economic relations among these countries will become closer and easier. This is clearly a sign of the way in which the world is going, Globalization. However, these are only estimates based on past data on trade statistics. It could be possible that there may be conflicts arising in the process of accomplishing the FTAA because of the complexity issue of such negotiation. There are 34 countries involved with different cultures, languages, currencies, technologies, political structures, etc and this adds to the complexity of forming a free trade area. This will take a long time until the world can see results but let's compare to the European Union. They took decades to for in a true union and they had to struggle over the years. It is a union that still in process of fortifying but it sure has the potential of becoming a world power in the international environment. The FTAA can be a possible union but a long process of changes and reorganization has to come along with it.

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