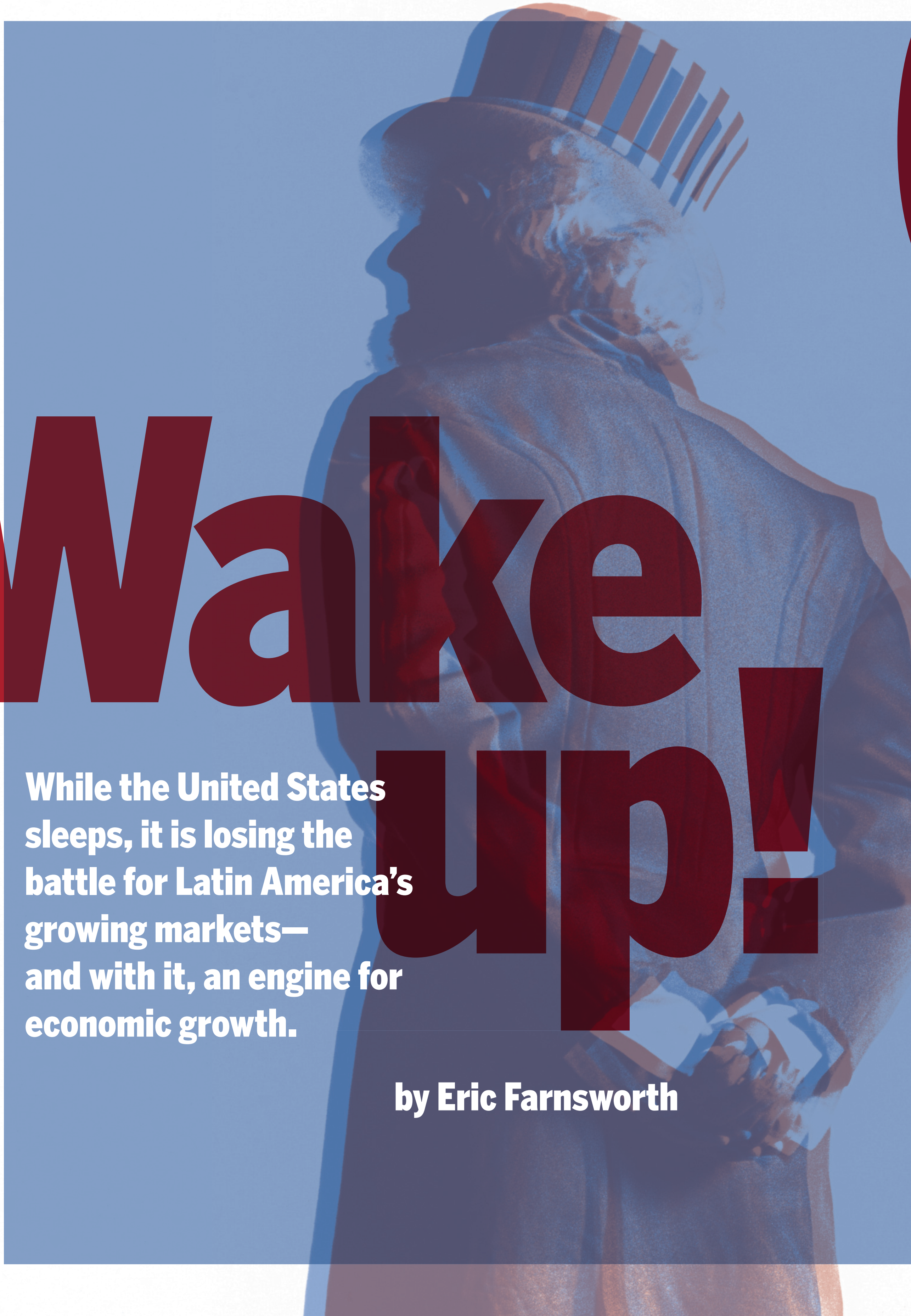

Wake up!

While the United States sleeps, it is losing the battle for Latin America's growing markets—and with it, an engine for economic growth.

by Eric Farnsworth

On December 3, 2009, President Barack Obama hosted a special White House summit on jobs. With the United States deep in the throes of the most severe economic downturn since the 1930s, and with unemployment hovering around 10 percent, the administration was determined to show an anxious public its commitment to finding ways to get people back to work. Among the challenges raised by summit participants was the need to expand exports. A month and a half later, the President made it clear that he got the message.

In his 2010 State of the Union Address, Obama noted the urgency of increasing exports and committed his administration to work toward passage of three bilateral trade agreements with South Korea, Colombia and Panama that had been stalled since 2006. Advocates of increased U.S. trade with Latin America cheered. The governments of Colombia and Panama were ecstatic. But even if these agreements are eventually passed, renewed momentum in trade may not recover the ground that the U.S. has already lost in Latin America. While Washington has dawdled, its hemispheric partners have looked elsewhere—to Asia, Europe and Canada. Whatever the fate of the Colombia and Panama trade agreements, the truth is that the United States has lost market share in Latin America.

This is an historic shift. Including Canada and Mexico, some 40 percent of U.S. exports have traditionally gone to the other countries of the Western Hemisphere, whereas the United States absorbs over 40 percent of the region's exports. U.S. trade with Canada and Mexico approaches $2 billion every single day. Nearly 50 percent of U.S. oil imports originate in the region; Canada is our top energy supplier; and Mexico, Venezuela, Brazil, Colombia, and Trinidad and Tobago, among others, are also important sources of energy. We sell more to the Americas than to the EU, more to Chile than to Russia, and more to Colombia than to Indonesia. And U.S. products run the gamut from agriculture to earth movers to high-tech computers, software and the services that accompany them. This is not a market that we as a nation can afford to ignore.

Can market share be recovered? Despite the Obama administration's stated interest in trade expansion, it remains uncertain whether it can carry the argument in a domestic climate where trade liberalization is perceived as a threat to jobs. Nonetheless, on March 11, 2010, the White House issued an executive order to establish the National Export Initiative (NEI) "to improve conditions that directly affect the private sector's ability to export." The explicit goals of the NEI included actively opening new markets, reducing significant trade barriers and "robustly" enforcing trade agreements.

A meaningful national export strategy requires prioritizing contacts with regions that offer the highest potential for growth, leading to greater purchases of goods and services from the United States. Latin America is one of those regions. And, although NEI is concerned with invigorating global trade in the aftermath of the global financial meltdown, it offers a potentially useful approach to increasing ties to the economies south of the U.S. border. A number of Latin American economies, notably Brazil, Chile, Colombia, Peru, and Panama, have emerged from the economic crisis stronger, with economic growth rates in some cases approaching Asia's—even as the U.S. continues to experience sluggish growth. Even Mexico, closely tied by geography to the still-sluggish U.S. economy, is recovering.

THE RISKS OF OVERSELLING

Closer economic ties with Latin America's stronger economies would allow the U.S. to sell more of its goods and services, thereby increasing exports and creating jobs at home. Of course, international trade also includes imports, as well as cross-border investment flows. But for simplicity and political purposes, this Administration, like many before it, chose to focus on sales, rather than purchases—reinforcing the belief of many voters that exports are inherently "good," while imports are inherently "bad."

This is an unfortunate extension of a debate in the U.S. that began a generation ago with the passage of the North American Free Trade Agreement (NAFTA), the first trade pact to link countries from the developed and the developing worlds. At the time, Secretary of State James Baker promoted NAFTA with the mantra that it would bring "jobs, jobs, jobs," and other supporters said that it would promote exports and thus improve the trade balance.

When Mexico devalued its peso shortly after NAFTA passed (a bungled effort that led to financial crisis and the need for rescue from Washington), the terms of trade shifted, making U.S. exports more expensive for Mexicans and imports from Mexico less expensive for Americans. As well, foreign direct investors found Mexico more attractive both legally, under the terms of NAFTA, and economically—and they invested heavily.

The entirely predictable result was that the trade balance with Mexico turned negative. Many people subsequently came to the conclusion, endlessly hyped by trade opponents, that jobs were being lost, when every credible study has found that jobs increased in all three NAFTA countries after the agreement went into force.

What changed somewhat was the mix of jobs in each country. But NAFTA did what it was designed to do: increase trade and investment among its three parties.

This history is instructive because the proponents and opponents of trade agreements saw different things. Proponents considered NAFTA an economic success, noting that it forever bound North America together as one economic space, thus improving competitiveness and markets in an increasingly global environment. NAFTA's defenders argued for what they believed was the logical next step: expanding the pact to cover the entire hemisphere through the Free Trade Area of the Americas (FTAA), which would use hemispheric economic integration as a means to build competitiveness in the face of European and Asian integration efforts.

NAFTA opponents, on the other hand, saw the agreement as an economic disaster, (improbably) costing jobs in all three nations. Some saw it as a stealth attempt to create a single North American political entity that would supersede national sovereignty. Instead of expanding NAFTA, they wanted to kill it, and worked aggressively to undercut the FTAA as "NAFTA on steroids"—a clever, if misguided, phrase.

The debate forced President Bill Clinton's administration to back down from the strategy it set during the Miami Summit of the Americas in 1994, which envisaged Chilean accession to NAFTA as the beginning of an interlocking series of trade pacts in the hemisphere. Instead, Chile was offered a separate bilateral agreement with the United States. This was a subtle but important shift, and it was done so that the Chile agreement could be promoted independently of the political baggage accumulating around NAFTA.

It also signaled to the rest of the hemisphere that support for trade expansion in the United States was soft, and that there was room to maneuver on hemispheric trade despite the Miami Summit consensus.

The second Summit of the Americas in Santiago in 1998 was the symbolic launch of FTAA negotiations. But it barely moved beyond the symbolic stage. Congress refused to renew fast-track trade negotiation authority for the President, which had lapsed in 1995. There was limited progress on the Chile agreement. And with Clinton in the final two years of his second term, the hemispheric trade agenda stalled.

Opponents continued to insist that NAFTA and broader trade expansion was a net negative for the United States, an idea that became conventional wisdom despite the fact that up to one-third of U.S. economic growth depended on trade and one-quarter of the U.S. economy was built on trade.

Meanwhile, the hemisphere was stirring. Brazil, in particular, was beginning to assert itself economically, having conquered inflation under President Fernando Henrique Cardoso, securing democracy after the military dictatorship and taking steps to focus on poverty alleviation and social development. Brazil's long-standing international vision was to gain a seat at the table of global decisionmakers, and a stronger domestic environment allowed it to take steps toward achieving that goal.

Economic development was essential to this strategy, and trade expansion a fundamental pillar. But Brazilian officials viewed these issues strategically. They made clear that a hemispheric trade arrangement led by the United States was not their priority; rather, they sought other means to the same end.

When domestic pressures hampered Washington's ability to press the FTAA agenda, Brazil stepped into the vacuum. It attempted to substitute its own vision of a stripped-down hemispheric trade agreement for the original comprehensive vision of the FTAA. By the time of the 2003 hemispheric trade ministers meeting held in Miami, the FTAA was essentially moribund. (Brazil played a similar role at the World Trade Organization gathering of trade ministers in Cancún, also in 2003.) There has not been any meaningful consideration of the FTAA since then.

Regional politics also played an important role in reducing interest in a hemisphere-wide agreement. The

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Bolivarian Alternative, or ALBA, explicitly rejects the previous hemispheric consensus and seeks to build a vision of economic integration that excludes the United States and others. The irony is that the nation most aggressively promoting the populist and protectionist ALBA vision—Venezuela—already enjoys virtually free trade: its primary exports of oil and gas are tariff-free on world markets. Nonetheless, actions by Brazil and the eight nations in ALBA (Venezuela, Bolivia, Ecuador, Nicaragua, St. Vincent and the Grenadines, Dominica, Cuba, and Antigua and Barbuda) broke the hemispheric trade consensus barely a decade after every nation except Cuba had signed on to the FTAA.

A BACKUP PLAN

When it became clear that a broader hemispheric agreement would not be possible in the near term, the U.S. strategy shifted to conclude agreements with various subregions of the hemisphere, including Central America, the Andes, the Caribbean, and eventually Brazil and MERCOSUR. The thinking behind this shift was to stitch together agreements with subregions into a virtual FTAA—joined with the 1994 NAFTA pact and 2003 Chile agreement—which Brazil, Latin America's largest economy by far, would then feel compelled to join.

To the extent that the strategy was designed to force Brazil to the table, however, it was doomed from the start, driven more by wishful thinking in President George W. Bush's administration than by a skilled analysis of Brazilian interests and likely reactions. Still, the effort led to agreements with Central America (the Dominican Republic having been clumsily added after negotiations had already begun); Andean nations (Bolivia and Ecuador were unprepared to conclude an agreement and thus dropped out of the discussions, leaving Colombia and Peru to finalize bilateral accords with the United States); and Panama.

Yet even this strategy proved a bridge too far for hemispheric trade.

The Central America–DR agreement passed in 2005, and Congress passed the Peru agreement in 2007. But the Colombia and Panama agreements, despite being signed in 2006 and 2007 respectively, have yet to be presented to Congress. The midterm elections in 2006 put Democrats in charge of both chambers, and the new Democratic leadership forced the renegotiation of the agreements to include greater protections for labor and the environment, among other issues. The changes were sufficient to secure the approval of the FTA with Peru, but despite the fact that the Colombia and Panama agreements contained similar provisions, Congress sent a clear signal that it was not ready to approve them, for reasons unrelated to trade. It remains to be seen how the new Congress, elected on November 2, 2010, will deal with these issues.

During the 2008 Democratic primaries, both Obama and Hillary Clinton called for the renegotiation of NAFTA, and opposed the pending agreements with Panama and Colombia. After the election, the pilot project on cross-border trucking with Mexico under NAFTA was terminated, the Security and Prosperity Partnership for North America was abandoned, and "Buy American" provisions were inserted into the stimulus package. Even the relatively non-controversial initiative begun at the very end of the Bush Administration to stitch together existing hemispheric agreements in order to improve efficiencies, called Pathways to Prosperity, was refashioned by the Obama administration as a social development pact focusing primarily on microenterprise, rural development and social inclusion of women and girls.

By the time of the 2009 White House Summit, Washington had worked itself into a political box on trade, to the point where the best it could do was promote U.S. exports in a down economy, rather than articulate and support a more meaningful trade expansion strategy.

Some observers have argued that this means the trade agenda no longer exists in the hemisphere. That's not correct. There is a huge trade agenda. It's just that, for the first time in modern history, not only is the U.S. not leading the efforts, it's not even part of the discussions.

THE COST (AND WAY OUT) OF U.S. TRADE PARALYSIS

The lack of an overall organizing structure for hemispheric trade relations, and the subsequent lack of U.S. engagement on the issues, has had important economic, trade and strategic implications that policymakers have yet to appreciate.

The bottom line is that as Washington remains reluctant to engage aggressively on hemispheric trade expansion, arguing over whether trade is good for the U.S., the rest of the world is moving ahead smartly to take advantage of our recalcitrance.

Since the agreement with Colombia was signed, for example, Colombia concluded negotiations with Canada, the European Free Trade Association and the European Union, and completed implementation of its agreements with Chile, El Salvador, Guatemala, and Honduras. Colombia has also launched negotiations with erstwhile

U.S. free trade partners Panama and South Korea. As a result, Colombian imports from elsewhere have begun to outpace those from the United States.

Whereas U.S. agricultural exports to Colombia grew at an average annual rate of 38 percent from 2004–2008, they declined by almost 50 percent in 2009 as Colombia imported agricultural products from globally competitive nations like Argentina and Brazil. Prevailing global economic conditions contributed to this decline; nonetheless, the implementation of the Colombian agreement with MERCOSUR and the refusal of the U.S. to pass its own bilateral agreement with Colombia were the primary causes of the sharp drop in U.S. agricultural exports to Colombia, according to a May 10, 2010 Congressional report. Expect this trend to accelerate once the Colombian agreement with Canada comes into force.

More broadly, the overall U.S. share of Colombian imports has fallen from 32 percent in 2002 to 28 percent as of 2008. Market share will be difficult to win back, if and when the U.S. finally acts on the pending agreements; once the Canadian Wheat Board or Argentine cattlemen win Colombian market share from U.S. producers, there will be little incentive to go back to the United States.

Compare this scenario to Chile. In the time that the bilateral free trade agreement has been in force, U.S. market share of Chilean imports has climbed from 14 to 20 percent.

These are not just statistics. They represent real jobs for real people. But given the nature of production and global supply chains, the argument for prioritizing trade is even more compelling. With a choice of exporting goods to Colombia from a plant in Canada with a trade agreement versus a plant in the U.S. without a trade agreement, companies will choose to export from Canada, because the exact same product will be able to enter the Colombian market duty-free.

Multinational companies skillfully arbitrage international trade agreements to take full advantage of tariff rate cleavages and they will reap the reward regardless. Those directly affected are laborers. In this case, Canadian jobs grow while U.S. jobs are reduced. If U.S. workers understood that in some cases their jobs are at risk, rather than protected, because their national leaders have demonized trade expansion, the nature of the domestic trade debate might change.

But there is an even tougher pill for U.S. workers to swallow. The U.S. is no longer the hemisphere's default trade partner. That role is slowly being filled by China, which has already become the largest trade partner of

Peruvian Potatoes for Peruvian Consumers

by Mateo Samper

IMAGE SOURCE/GETTY

The remote Andes are the source of one of the world's newest potato chips. Poor farmers in the mountainous Huánuco, Junín and Huancavelica regions of central Peru have been cultivating potatoes for centuries, mostly for their own consumption. But their lives changed in 2006 when PepsiCo, together with NGOs and local communities, began researching the more than 3,500 rare potato varieties produced at altitudes between 12,500 and 14,000 feet. The result: Lay's Andina, a potato chip with modest roots and high-class goals.

Launched on the market on May 30, 2008, Andina chips are made from seven seasonal potato varieties native to the Peruvian Andes and manufactured in preexisting PepsiCo factories across Peru. They are high in antioxidants and other nutrients and are "healthier than regular chips, low in sodium and saturated fat, and keep much longer," explains Antonio Escalona, South Andean General Manager of PepsiCo Foods. They also cost more. Andina chips sell at twice the price of Lay's Classic chips in Peruvian supermarket chains.

Andina's customers, so far, come largely from high socioeconomic brackets. But the initiative also serves as an example of how a company can promote community and economic development while sticking to its core business. Even though Andina represents only 1.5 percent of Lay's market share in Peru, the new product has had a huge impact on the small communities of potato farmers who supply the raw materials. For example, 170 families and 3,000 individual farmers have seen their incomes increase as a result of the 25 percent higher payment they receive per kilogram of potatoes than farmers of Lay's potatoes. Furthermore, enrollment rates for kids and literacy rates in the region have shot up, not only because parents can now afford to send their kids to school, but because PepsiCo has built two primary schools and two schools for adult education.

PepsiCo also works with NGOs to train farmers in more efficient, sustainable farming methods, hoping to increase potato crop yields to 12 to 15 tons per hectare (from current levels of 3 to 5 tons per hectare) while respecting the environment. They teach farmers about irrigation, soil treatment and pesticides to help them improve the yield of their plots and better conserve their land. "We believe that by working together with the community, we will keep improving Andina to make it more profitable, while contributing to the well-being of everyone involved, including the farmers, the consumers and of course, our environment," Escalona says.

The irony is that the nation promoting the protectionist ALBA—Venezuela—already enjoys virtually free trade with the U.S.

Brazil and Chile and may soon be the largest partner for Peru. Chile and Peru both have agreements in force with China, and Brazil declared China to be a market economy—with attendant trade benefits—in 2004. China also signed an agreement with Costa Rica in 2010, and additional agreements are likely.

The trade statistics illustrate this stark shift. Between 2002 and 2008, U.S. market share in the top eight hemispheric economies dropped from 49 percent to 38 percent. During the same period, China's share more than doubled, from 4 percent to 10 percent. What these agreements have done is to establish patterns of trade in strategic sectors, locking in Chinese access to raw materials from oil and gas to minerals and agricultural products. They have also brought Chinese investment, which often lacks the same job-creating and social responsibility activities as Western investment. They have further encouraged Latin America to pursue development based on the sale of primary products, rather than knowledge-based, value-added goods and services, with important implications for Latin America's own development. India, too, is beginning to discover the region, and is likely to focus more heavily on services. An agreement with MERCOSUR has been in force since the middle of 2009.

The race is on for the Western Hemisphere—a new gold rush as it were. Amazingly, the U.S. seems content to sit this one out and let other nations reap the reward.

At the same time, the lack of a coherent trade framework for the hemisphere as a whole has led to a mishmash of agreements among countries, covering different products, trade disciplines, phase-outs, and other inconsistencies. By July 2010, the number of trade pacts and customs unions involving hemispheric nations totaled 64. The number of pending agreements or those in negotiation totaled 71 more; another negotiation was launched in November 2010 at the G-20 in Seoul between South Korea and Peru.

The U.S. is a party to only 11 FTAs in force—four with hemispheric nations—and three more signed but not yet in force (South Korea, Colombia and Panama). One negotiation, the Trans-Pacific Partnership, is currently underway. But the explosion of trade agreements to which the U.S. is not a party, including the Arco del Pacífico, ALBA, South American unification efforts—including MERCOSUR expansion—and multiple bilateral agreements, means that others are setting the rules of the game. By definition, they are doing so in the manner most advantageous to themselves. Those same rules will not necessarily be the most advantageous to the U.S., but they will determine trade and investment patterns for years to come.

From a strategic economic perspective this makes little sense. It also makes little sense to cede regional market share—and the political influence that comes with it—just when the U.S. economy is struggling to recover and Latin America is one of the emerging markets leading the global economy out of its deep slump.

The Obama administration is right to look to international trade expansion as a jobs creator. But it's one thing to be committed to trade expansion and quite another to use political capital with friends and foes alike to get it done.

Talking up exports is a start. There must be more.

A smart Washington trade agenda must develop a sense of urgency about passing the Colombia and Panama agreements. But it must also focus on a number of other steps to win back lost ground in the Americas. These must include:

- using the Trans-Pacific Partnership and the Pathways for Prosperity as important strategic vehicles to build a broader, strategic hemispheric trade agenda;
- developing a realistic, focused and sustained strategy for engaging Brazil; and
- thinking creatively about broader hemispheric trade facilitation agreements, perhaps on a sectoral basis, such as clean energy or autos.

Without these steps, U.S. economic and political leadership in the hemisphere—and with it, the industries and workers who depend on our ties to the hemisphere—will continue to decline. Those in the policy community and overseas who find U.S. power and influence in the hemisphere distasteful or threatening will celebrate Washington's abdication of its historic trade leadership role. But the rest of us, concerned about job creation, the economy, and America's place in the world, should demand a different approach.