

## Does the FTAA Have a Future?

Jeffrey J. Schott  
Senior Fellow, Institute for International Economics

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The negotiation of a Free Trade Area of the Americas (FTAA), involving 34 democratic countries in the Western Hemisphere, has struggled to advance over the past decade. The deadline for concluding the talks passed virtually unnoticed at the start of 2005. Currently, the initiative is moribund.

As originally vetted, the FTAA is the most ambitious free trade initiative of the postwar trading system. Never before have so many countries of such diverse sizes and levels of development joined to negotiate a *reciprocal* free trade pact. Under the best of circumstances, crafting such a pact would be difficult. But negotiators have not been so lucky. Their task has been complicated by the financial crises and political turmoil that beset many Latin American participants over the past decade, the new security imperatives of the post-9/11 world, and now the prospective expiry of US trade promotion authority in June 2007.

Can the FTAA negotiations be revived? As government leaders prepare for the next Summit of the Americas in Mar del Plata, Argentina, in November 2005, the unbridled optimism evidenced at their previous summit in Quebec City in 2001 seems to have given way to rampant pessimism. Many countries seem distracted by pressing economic and political problems at home; all face the challenge of adjusting to rapidly changing conditions in the global economy generated by technological innovation and by the emergence of the Chinese trading juggernaut. Not surprisingly, questions have been raised whether

governments can fulfill their lofty summit promises—or whether they even still want to do so.

This short paper examines the current status of the FTAA negotiations and posits what needs to be done to get the talks back on track. To better understand the current negotiating stakes, I first briefly discuss the historical factors that precipitated the hemispherewide trade initiative.

### **Why Did Countries Want an FTAA?**

Why did the countries of Latin America and the Caribbean (LAC) reverse decades of antipathy to formal trade ties with the United States and support—and in some cases actively lobby for—a free trade deal with the world’s industrial superpower? The answer is complex and requires more analysis than can be devoted in this short paper. But in most cases, the policy reversal reflected a sea change in national economic policies and development strategies caused by the failure of the import-substitution model of development of the 1960s and 1970s, the collapse of debt finance in the wake of the Latin American debt crisis of the 1980s, and the inexorable competitive pressures emanating from the advance of globalization.

Why did the United States promote the idea of an FTAA with the LAC region? Visions of a hemispherewide free trade zone were expounded by Ronald Reagan a generation ago but were shunted aside during the lost decade of the 1980s as debt problems, high levels of trade protection, civil strife, corruption, and autocratic rule in the LAC region burdened US–Latin American relations. About 15 years went by until Reagan’s ideological antipode, Bill Clinton, revived the vision as the centerpiece of a renewed summitry initiative.<sup>1</sup>

While Reagan may have put the vision of hemispheric free trade into words, the leaders of Mexico deserve credit for taking decisions that provoked other LAC countries to embrace trade talks with the United States. Mexican President Miguel de la Madrid turned to economic reform in 1985 essentially because there were no other viable alternatives. Carlos Salinas followed and accelerated the reform program during his term in office. His pivotal

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<sup>1</sup> For an insider’s account of the evolution of the 1994 Summit of the Americas, see Feinberg (1997).

decision to request a free trade agreement (FTA) with the United States in early 1990 can be seen as the first concrete step toward a hemispheric trade pact. Instead of slowing down the reform process to “digest” the substantial economic adjustments incurred in the 1980s, Salinas used the prospect of the FTA to accelerate the pace of economic change within Mexico and to encourage inflows of foreign direct investment (FDI). In fact, the mere announcement effect of FTA talks elicited significant new commitments of FDI in Mexico in anticipation of the new trade regime with the United States (see Hufbauer and Schott 2005, chapter 1).

When Mexico and the United States announced the launch of FTA negotiations in June 1990, which evolved into the North American Free Trade Agreement (NAFTA) when Canada joined the talks several months later, other countries in the LAC region faced a new competitive challenge for market share in and FDI from the United States. The purpose of NAFTA for Mexico was to complement ongoing domestic reforms and create new trade and investment opportunities within the Mexican economy—some at the expense of neighboring countries. The prospective NAFTA preferences posed a real competitive threat to countries participating in the Caribbean Basin Initiative (CBI) and in the Andean Trade Preferences Act (ATPA)—since their tariff preferences in the US market were both time-limited and less comprehensive than the contractual obligations granted to Mexico under NAFTA. Those countries either had to emulate the Mexican reforms—following a strategy of competitive liberalization à la Bergsten (1996)—or risk losing trade and investment to countries offering a more hospitable business climate.

The United States could not say “no” to the audacious Mexican proposal, but US officials were cognizant of the potential adverse effects NAFTA could have on nascent economic and political reform in the LAC region. Accordingly, President George H. W. Bush announced the “Enterprise for the Americas Initiative” (EAI) just a few weeks after the US-Mexico decision to develop an FTA. The EAI had three main pillars: trade, finance, and debt. It was designed to support the new commitment to democracy and market-oriented reforms throughout the LAC region by expanding regional trade and investment and helping to reduce national debt burdens (by augmenting the Brady Plan). Trade was the

focal point of the EAI, with the ultimate goal of creating a Western Hemisphere FTA (see Hufbauer and Schott 1992).

The EAI soon was overshadowed by ongoing negotiations of NAFTA and the Uruguay Round and subordinated to new initiatives involving the rapidly growing nations of the Asia Pacific Economic Cooperation (APEC) forum. The onset of annual summit meetings of APEC leaders, starting in Seattle in November 1993, posed a sharp contrast to US relations with the LAC region. The LAC countries clamored to keep pace with APEC initiatives, especially the Bogor declaration of November 1994 that sought free trade and investment in the Asia Pacific by 2010 and 2020 for developed and developing countries, respectively. To its credit, the Clinton administration subsequently proposed a new Summit of the Americas to parallel the APEC process. The resulting meeting in Miami in December 1994 echoed the APEC commitment to free trade and investment issued three weeks earlier with the mandate to negotiate an FTAA within a decade.<sup>2</sup>

The Summit of the Americas in Miami in December 1994 provided the original mandate for an FTAA that would progressively eliminate barriers to trade and investment in the hemisphere and targeted the completion of the negotiations no later than January 2005. After several years of consultations and preparations, the trade talks were finally launched after the Santiago Summit in April 1998. Trade ministers agreed to work on a comprehensive agenda of issues covering both market access and rulemaking. Talks were organized into nine negotiating groups.<sup>3</sup> In addition, a consultative group on small economies was established to ensure that the concerns of the majority of the FTAA participants were reflected in the work of each group. Committees on electronic commerce and on the participation of civil society were also convened.

Seven years later, the original deadline for concluding the trade deal has passed, and negotiations remain at an impasse. To date, the negotiations have produced a heavily bracketed draft text and little else. Negotiations to reduce barriers to market access for goods and services—the “guts” of any free trade pact—have barely progressed. The only positive

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<sup>2</sup> For a comparative analysis of the APEC and Western Hemisphere trade initiatives, see Feinberg (2000).

<sup>3</sup> The groups cover market access for nonagricultural goods, agriculture, services, intellectual property rights, subsidies and antidumping/countervailing duties, government procurement, investment, competition policy, and dispute settlement.

development to report is the very modest “capacity-building” initiatives advanced by the Inter-American Development Bank and some national development agencies that have addressed critical infrastructure and administrative problems in smaller economies.

### **What Is the FTAA Really About?**

The FTAA was never meant to unite the economies of the Western Hemisphere; it merely sought to eliminate barriers to trade and investment among participating countries. To be sure, some officials projected a broader vision of the FTAA, and sought to borrow elements of the European integration model for the FTAA process, particularly the use of regional aids to promote growth in less-developed countries. Small developing economies have called for special FTAA funds to transfer resources from North America to poorer parts of the LAC region akin to the regional development grants funded by the richer, northern European countries as inducements to get new members to join the European Community. Similarly, Mexican leaders also have sought increased NADBank financing for public infrastructure projects. None of these countries, however, buys into the political side of the European bargain—the ceding of sovereignty to supra-regional bodies—since in the Western Hemisphere context that would translate into US hegemony over the LAC region.<sup>4</sup>

For that reason, the FTAA always had a more traditional and discrete trade objective: to remove barriers to trade in goods and services between the countries of North and South America. It is not a surrogate or a channel for development aid; however, the trade and regulatory reforms implemented in response to FTAA provisions can and should be important components of national development strategies. Indeed, what distinguishes the US-LAC trade initiatives from many ventures between other developed and developing countries around the globe is the recognition by the developing countries that they need to adjust their domestic policies both to attract foreign investment and to promote competition in the home market. Without sustained economic reform—abetted by FTAs but primarily

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<sup>4</sup> Postwar European integration has both political and economic dimensions. Countries have been willing to cede sovereignty to supra-regional authorities as part of the process of creating a more politically unified Europe. Part of the glue of the alliance was transfers mandated by the common agricultural policy. In addition, new entrants received regional aids to assist in the adjustment to the common European regime. This is obviously only a caricature of the process of European integration. However, it suffices to make the simple point that the European experience has had much broader economic and political goals than those sought in the FTAA.

driven by domestic development imperatives—trade pacts will not generate the expected gains to trade and economic growth.

As mandated by the summit leaders, the FTAA is a self-contained negotiation among the 34 democratic countries in the hemisphere. As a practical matter, however, these countries already are moving toward free trade at different speeds with different countries in the region. There already are numerous FTAs linking countries in North and South America, FTAs or customs unions among LAC neighbors, and a variety of “partial scope” trade accords that grant sector-specific benefits to bilateral trading partners. Except for NAFTA, most of these accords involve small volumes of trade: For example, intra-Mercosur exports in 2003 totaled only \$12.7 billion or 12 percent of global exports of the four countries (down from 25 percent in 1999 and about the same percentage as when Mercosur was signed in 1991). By contrast, intra-NAFTA exports were valued at about \$609 billion in 2003 and accounted for 57 percent of total exports of the three countries that year—and almost 80 percent of total trade between the Western Hemisphere countries (IDB 2004).

The United States accounts for much of the hemispheric trade and large shares of the total trade of the Central American and Andean countries. Moreover, much of that trade is or will be liberalized under existing and prospective FTAs. The United States already has implemented FTAs with Canada, Chile, and Mexico; has ratified pacts with the five Central American countries and the Dominican Republic; and is currently negotiating FTAs with Colombia, Ecuador, Panama, and Peru. In addition, the Caribbean Basin Trade Partnership Act of 2000 (CBTPA) extends US unilateral tariff preferences to most Caribbean exports not covered by the CBI through September 2008.<sup>5</sup> What’s left not subject to free trade commitments is mainly US trade with Mercosur and with Venezuela.

Why then bother with a FTAA? The short answer is that an FTAA would yield both economic and foreign policy benefits. First, the FTAA would have beneficial effects on the conduct of overall economic policy in and economic relations among the participating countries. Second, the FTAA initiative covers the one big gap in the free trade matrix of the

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<sup>5</sup> The CBTPA provides “NAFTA parity” for products (mostly textiles and apparel) excluded from the Caribbean Basin Economic Recovery Expansion Act of 1990, known as CBI II. Unlike the CBI preferences that have no termination date, the supplementary benefits under CBTPA must comply with NAFTA rules of origin and expire on September 30, 2008.

Western Hemisphere, linking the major economies of North and South America, whose bilateral trade—as projected by gravity models—could expand two or threefold in response to FTA-type reforms.<sup>6</sup> At the same time, the hemispherewide FTA would help harmonize over time the separate free trade regimes that have been negotiated among regional trading partners. Third, and perhaps most important, the FTAA is the economic engine that drives hemispheric cooperation on more than 20 initiatives undertaken by leaders at the Summit of the Americas involving a number of political, socio-economic, and cultural issues (e.g., promoting education, strengthening the rule of law, and protecting the rights of indigenous peoples). Progress on the FTAA is critical to sustain efforts in these other areas.<sup>7</sup>

Many LAC countries already have open access to the US market for most merchandise products because of CBI and ATPA preferences, or because US most favored nation (MFN) tariffs are zero or very low. Of course, there are a few notable exceptions, mostly involving agricultural goods; these products have been immune to deep MFN reforms and often are excluded from FTA or unilateral trade preferences. For many countries, the value of their bilateral FTAs and the FTAA is more secure access to the US market since these trade pacts turn their unilateral preferences into contractual obligations. By “locking in” open access to markets, free trade pacts help reduce uncertainty about the future course of trade and regulatory policies and thus facilitate business planning and investment. For many developing countries, this benefit is a key to the success of their investment-led development strategies.

For small economies, particularly those in the Caribbean, the stakes are even greater. For them, the issue is not whether to integrate with their hemispheric trading partners but how to do so. Given their size, heavy reliance on the production and trade of a single commodity or service, underdeveloped physical infrastructure, and limited human and technological resources, these countries cannot afford to isolate themselves from their major markets since they are unlikely on their own to reap sufficient economies of scale and scope to compete effectively in global markets. The challenge for these countries is threefold: encouraging growth in trade and inward investment from their FTAA partners; restructuring

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<sup>6</sup> Bilateral trade between the United States and Brazil is relatively small; two-way trade was \$35 billion in 2004—by contrast, US-Mexico trade was valued at \$266 billion. The FTAA would provide the first major trade accord between the United States and Brazil and its Mercosur partners.

<sup>7</sup> For more detailed discussion of FTAA benefits, see Schott (2001).

their economies to diversify the mix of production and expand employment opportunities; and managing the political backlash that inevitably will be provoked by the substantial adjustment burdens required to implement FTAA obligations.

### **FTAA: Current Status**

Bluntly put, the FTAA negotiations have been stuck in the mud since the Miami ministerial meeting of November 2003. At that time, soon after the failed World Trade Organization (WTO) meeting in Cancun in September 2003 that had led to a breakdown in the Doha Round of multilateral trade negotiations, trade officials were under intense pressure “not to fail.” Moreover, trade ministers didn’t want their leaders to have to address the ensuing mess when they convened in Monterrey, Mexico, two months later for a special Summit on Development. So the political imperative was to cut a deal in Miami and go home quickly. Accordingly, the co-chairs of the FTAA process—the United States and Brazil—produced a procedural compromise that allowed them to shake hands and promise to resume negotiating in early 2004. Despite infrequent bilateral meetings of ministers and chief negotiators, the US-Brazil rapprochement never advanced beyond a handshake to an *abraço*.

The outcome of the Miami ministerial prevented the collapse of the trade negotiations but made it more difficult to achieve an agreement that balanced the interests of the participating countries. What went wrong?

At the Miami meeting, ministers “affirmed their commitment to a comprehensive and balanced FTAA” (paragraph 5), which includes “provisions in each of the [FTAA] negotiating areas” (paragraph 10). However, countries were permitted to take specific issues or products off the table, and some “countries may assume different levels of commitments” (paragraph 7). If other countries want to do more, say on investment, they could enter into “plurilateral” agreements that only obligate those countries that sign the specific pact. In other words, the Miami compromise accommodated two levels of negotiation: a core FTAA in which countries could exclude sensitive issues and supplementary accords by a subset of FTAA participants that covered “FTAA-plus” commitments.

The plurilateral option was introduced to accommodate the incremental development of an FTAA through a series of iterative negotiations. In so doing, however, it seemed to walk away from the comprehensive trade accord that hemispheric leaders promised at the Summit of the Americas in 1994 and had reiterated at their subsequent reunions in Santiago (1998) and Quebec City (2001). Some countries took the Miami mandate as license to try to remove entire areas from the talks—leading some observers to derisively label the potential outcome “FTAA-lite.” The Brazilians certainly thought that they had pared down the negotiating agenda to core issues that need not include subjects sensitive to them—particularly, investment and intellectual property rights (IPRs)—but such a result is not viable since the United States could not agree to liberalize its own border barriers to trade in the absence of reciprocal benefits for US traders and investors. If action on key trade and investment issues is deferred, will US or Brazilian officials be able to garner political support to reform long-standing barriers protecting farmers, manufacturers, and service providers?

In essence, the Miami declaration presaged a “hollow core” agreement in which individual countries could avoid committing to reforms in politically sensitive areas (hence “FTAA-lite”). Thus, if Brazil and others did not want to negotiate on investment and IPRs, they could opt out of a hemispheric accord in those areas while the United States and others could adopt a more comprehensive accord among a subset of FTAA participants (probably the same countries that already have signed FTAs with the United States). The value of this plurilateral approach is unclear, since there is little “additionality” if the plurilateral pacts only involve existing US FTA partners.

At best, plurilateral pacts would seek to harmonize the terms of existing FTAs. However, such harmonization would require *inter alia* augmenting Canadian obligations in NAFTA and unraveling politically sensitive compromises on FTA origin rules for textiles, clothing, and agricultural products. Such a result is highly unlikely. While it is conceivable that a more limited outcome could balance US and LAC interests, the trade benefits resulting from such a modest undertaking would not seem sufficient to justify the political cost/risk of going back to Congress for another vote on these pacts. For Congress to approve changes in existing US trade barriers of interest to Brazil and other Latin American

countries, US negotiators need to receive concrete commitments that open access to those markets for US exporters and investors. In short, the FTAA has to be a big deal, or the deal won't fly.

In sum, the Miami declaration complicated the task of crafting a balanced package of concessions that negotiators can sell to their respective legislatures. It took pressure off the Brazilian negotiators by giving them an excuse for their minimalist position on so-called WTO-plus issues—i.e., those that go beyond the scope of existing WTO rights and obligations. For Brazil, the Miami decision seemed to condone an FTAA that simply removed traditional border barriers and did not require commitments on new issues like investment and competition policy. At the same time, it allowed US officials to defend inaction on US farm barriers because of lack of reciprocity from their Brazilian counterparts. In short, the talks have devolved into a caricature of the “Alphonse and Gaston” routine, with neither side willing (and possibly not politically able) to advance first.

### **Does the FTAA Have a Future?**

Developments in two areas offer some hope that the FTAA can be revived and concluded (though perhaps not on the current timetable). First, recent progress on disciplines on agricultural subsidies in the Doha Round has reopened prospects for reviving the FTAA talks, which like the WTO talks, have been stalled due to differences over agriculture. The WTO framework agreed on August 1, 2004, in Geneva includes a firm commitment to eliminate agricultural export subsidies and to substantially reduce domestic support and border barriers to trade in farm products. The WTO ministerial meeting in Hong Kong in December 2005 hopefully will clarify the scope and depth of the reduction in farm subsidies and border barriers in the Doha Round and thus provide a clearer political signal that many of the objectives of the hemispheric pact in this sector will likely be implemented on an MFN basis once the Doha Round accords are ratified. In that case, FTAA negotiators should be able to focus their efforts on market access problems involving specific products traded between Western Hemisphere countries.

Second, although the FTAA talks have drifted, concrete FTA negotiations have advanced among subsets of FTAA participants. This is not necessarily bad for FTAA

prospects. If the bilateral and subregional accords accelerate the pace of economic reform, they will contribute importantly over time to the ability and willingness of LAC countries to undertake the reciprocal obligations of the broader hemispheric pact. Indeed, US officials deliberately have moved forward with bilateral FTAs with a number of LAC countries, challenging Brazil and its Mercosur partners to catch up when they are ready to proceed in the FTAA. Pacts with Chile, the CAFTA-5, the Dominican Republic, Panama, and the Andean-3—along with deepening integration in the NAFTA region—are designed to maintain momentum and establish negotiating precedents for the broader FTAA exercise.

For its part, Brazil has adopted a similar trade strategy: It has signed skeletal FTAs with most of its LAC neighbors and product-specific deals with Mexico and China and is negotiating a free trade pact with the European Union (whose progress lags as well). To date, the Brazilian strategy has scored political points in Latin America but made little progress in advancing Brazilian export interests in the major industrial markets.

Interestingly, the countries with the greatest interest in an FTAA today are the small, trade-dependent Caribbean countries that could suffer significant trade and investment diversion if their trade preferences in the US market are not transformed into permanent FTAA obligations. As noted earlier, key US tariff preferences under the CBTPA expire in September 2008; uncertainty over whether these preferences will be upgraded in a free trade pact, or worse yet not extended, will increasingly cast a cloud over development plans among the Caribbean Community and Common Market (Caricom) countries. These small economies stand to be the biggest losers if US-Brazil differences continue to stall the FTAA negotiating process.

The United States and Brazil will continue to co-chair the FTAA talks for their duration. However, a deal will not get done unless the leading economies of North and South America can bridge their differences and offer concrete new opportunities for their exporters and investors in each other's markets. If they succeed, then the FTAA will become a reality. If not, then the United States will continue to pursue FTAs with groups of LAC countries, which will effectively discriminate against the Mercosur-4. In that event, the FTAA negotiations will either continue to drift or devolve into an Asian-style "FTAA-lite." Either way, US trade policy will focus elsewhere.

The basic problem is twofold: whether Brazil will open its market to foreign competition in goods and services and whether the United States will reciprocate by increasing market access for Brazilian agriculture and competitive manufactures. In both cases, prospective liberalization is contentious and subject to a fractious domestic debate. In both cases, electoral and legislative considerations probably will constrain negotiations through much of 2006, if not longer.

In Brazil, recent political scandals have weakened President Lula da Silva and cast doubts about his reelection. Under these circumstances, the PT regime seems unlikely to risk further dissension within its own ranks by considering controversial policy reforms. Until the October 2006 election, Brazilian negotiators may thus resist negotiating over reforms of important regulatory barriers (including those for the services industries), strengthening protection of IPRs, and opening of some public procurement tenders to bidding by foreign suppliers. Such reforms are supported by some parts of the Brazilian business community but staunchly opposed by protectionist interests.

A FTAA deal could provide large inducements to undertake such reforms, but only if the United States commits in turn to provide concrete new trading opportunities in the US market for Brazilian farmers and industrialists—especially by slashing subsidies and committing to liberalization in politically sensitive areas such as cotton, sugar, tobacco, and citrus. In his speech to the United Nations in September 2005, President George W. Bush pledged that “the United States is ready to eliminate all tariffs, subsidies and other barriers to free flow of goods and services *as other nations do the same*” [emphasis added].<sup>8</sup> Loosely translated, this means that he will ask Congress to authorize trade and subsidy reforms commensurate with liberalization undertaken by the European Union and other major trading nations in the Doha Round. The success of this negotiating gambit will turn, however, on what Congress legislates in the new US farm bill that will be drafted in 2006.

Unfortunately, support for the FTAA within the United States has ebbed. At present, Congress is distracted by the war on terror, Iraq, hurricane relief, and Supreme Court nominees, and members rebel at the thought of another trade vote akin to CAFTA anytime soon. Indeed, the hangover from the CAFTA debate (which passed the House of

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<sup>8</sup> For the extract of Bush’s speech, with supporting factual detail, see USTR (2005).

Representatives by a 2-vote margin after extensive and expensive lobbying efforts by the administration) may be long-lasting on both ends of Pennsylvania Avenue.

Support for the FTAA from the US business community is more positive, especially among south Florida businessmen hoping to attract the headquarters of the FTAA secretariat, but not particularly active. US companies have focused their efforts on the Doha Round and on specific bilateral FTAs, where they expect a more immediate payoff (albeit small) than from the FTAA. US exports to, and investment in, the LAC region have lagged in recent years, further dampening enthusiasm. Since 2000, US shipments to the LAC region (including Mexico) have increased even more slowly than the sluggish 1.4 percent annual average growth for total US exports, and those to the Mercosur-4 declined significantly. While US FDI in the LAC region is reviving after dropping sharply earlier this decade, US outflows of equity capital have virtually dried up; most of the new US FDI is reinvested earnings of existing US subsidiaries. To be blunt, US business seems to be giving higher priority to other regions that offer greater prospects for trade and investment opportunities.

The Summit of the Americas to be held in Mar del Plata, Argentina, in November 2005 may provide an opportunity to break the current impasse. Political leaders need to reiterate their objective of achieving free trade in the hemisphere as part of the broader efforts to promote economic development and reduce poverty in the region. All FTAA participants except Venezuela have done so in past summits and should recommit to finish talks soon after the conclusion of the Doha Round. President Bush recently voiced his determination to follow through with the Summit of the Americas commitment at the NAFTA leaders meeting in Crawford, Texas, in March 2005; President Lula da Silva and other Latin American leaders should do so as well.

In particular, the Mar del Plata Summit declaration should provide a strong political mandate to restart the trade talks and direct the FTAA co-chairs to immediately consult with the other FTAA participants. The long-delayed FTAA ministerial meeting to be hosted by Brazil should be convened in 2006 to revive talks in all the negotiating groups, including agriculture. Trade ministers could then update the Miami mandate to reflect recent events, including the progress on agriculture and other issues in the Doha Round of WTO negotiations. One would then expect the FTAA talks to build on the results of the Doha

Round—which means that concluding the FTAA will require the reauthorization of US trade promotion authority in June 2007 (which, in any event, is necessary for the conduct of overall US trade policy).

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