



Executive Memorandum

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FREE TRADE WITH CHILE: ADVANCING U.S. POLICY IN LATIN AMERICA

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A primary goal of U.S. policy in Latin America is to promote economic and political stability. To this end, using its leverage as the world's largest and most attractive market, the United States urges trading partners to move rapidly on free markets and trade liberalization, which in turn foster the economic growth that serves as a catalyst for economic and political stability throughout the region.

This is a challenging task, especially at a time when the region is plagued with recessions, economic crises, and political instability that feed into a growing anti-American sentiment, caused by a perceived failure of U.S. pro-market policies and a complete misunderstanding of the reasons behind the U.S. military action in Iraq. These make a lethal combination that could undermine the U.S. goal of promoting liberalization in the region.

The U.S.–Chile free trade agreement (FTA) is an important first step toward the U.S. policy goal. FTA negotiations with Chile concluded last December, and the agreement now awaits the signature of both countries' presidents and the approval of their legislatures.

An FTA between Chile and the European Union has been in effect since February 2003. This means that if the U.S. walks away from the Chilean FTA, it will have abandoned Chile—and potentially the rest of Latin America—to the influence of France, Germany, and the other EU members. Therefore, it is strategically important for President George W.

Bush to sign the U.S.–Chile FTA next month and for Congress to approve it in order to reaffirm the U.S. policy of promoting regional economic and political stability and building friendships with Latin American countries.

For Europe, Against America. In the early 1990s, Latin American governments began to open markets, attract foreign investment, and consolidate democracy. However, reforms were not completed. As a result, this “partial opening” brought a spurt of economic growth that could not be sustained.

With the exception of Chile, Latin American countries still have bloated bureaucracies, convoluted taxes, and rigid labor laws and still lack the rule of law that helps to guarantee property protection. After growth peaked, most Latin American countries faced a recession for over three years and, in some cases, an economic crisis that wiped out the little wealth created during the reform years. Many governments have become weaker and politically unstable.

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Recessions and crises became fertile grounds for populist movements, which grew in Peru after the 2000 crisis, Argentina after the 2001 crisis, Uruguay following the Argentine crisis, Brazil with the 2002 presidential victory of a left-wing party, and Venezuela with the 1998 presidential victory of a leader of the 1992 military coup. These groups claim that U.S. pro-market policies caused their economic misery and that their countries should close their markets and promote self-reliance and greater welfare programs, much like those in Europe.

If they become more organized, populist groups could significantly influence policy. Populist leaders with positions in government could eventually align themselves with Europe and allow Europe to exert greater influence on their policies. In such an event, America's leverage to advance its regional policies would be significantly weakened.

A First Step Toward Regional Stability. Promoting open markets in Latin America is in the best interests of all concerned. Open markets will strengthen the economies of Latin American countries, their democratic institutions, and their political environments. Strengthening their ties with the United States will turn them into partners with the United States.

Free trade agreements are an excellent framework both for negotiating lower trade barriers and for setting the rules for reform, transparency, contract enforcement, and respect for the rule of law. Expanding free trade between the United States and the region will create economic opportunity that allows the people of Latin America to appreciate U.S. principles of political and economic freedom.

Signing and approving the FTA with Chile is the first step toward the U.S. goal of Latin American economic liberalization. The approval of this agreement is important for both economic and political reasons:

- **Economics.** According to the National Association of Manufacturers (NAM), the absence of a U.S.–Chile FTA costs U.S. exporters \$800 million per year in sales, affecting 10,000 U.S. jobs.

The NAM estimates that the largest losses of U.S. market share in recent years were in wheat, corn, soybeans, paper, plastics, paints and dyes, fertilizers, heating equipment, and construction equipment.

- **Politics.** An FTA with Chile locks in Chilean reforms and requires more reforms, such as the elimination of capital controls, the streamlining of regulations on intellectual property rights, and the establishment of transparent rules for contracting services. These reforms will turn Chile into a Latin American success story that other countries will want to imitate, both as a model of success and as a means of accessing the U.S. market. Equally important, the FTA with Chile will show other countries that the United States is committed to strengthening ties with the region. Such a signal will weaken the populist anti-American message and encourage countries to align themselves with the United States by adopting the American principles of economic and political freedom and the rule of law.

Conclusion. The United States wants to promote economic and political stability in Latin America. The best strategy for the U.S. is to use its leverage as the world's largest and most attractive market to negotiate rapid economic liberalization so that Latin American economies become healthier and their political environment more stable. At the same time, this will strengthen America's ties with this important region and dissuade Latin American countries from exploring an economic alliance with Europe against the United States.

The U.S.–Chile FTA is the first step toward this goal because, as the FTA turns Chile into a success story, other countries will want to follow suit. It is therefore strategically important for President Bush to sign the U.S.–Chile FTA next month and for Congress to approve it promptly, both to promote economic and political stability in the region and to build new partnerships with Latin America.

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