Executive Memorandum

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Consolidate U.S.–Uruguay Trade Ties Now

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Sometimes good things come in small packages. The recently negotiated bilateral investment treaty (BIT) with Uruguay is a case in point. Not only would it strengthen investment and commerce between the United States and this friendly South American nation of 3.4 million people, but it could also help to advance economic freedom in other parts of the continent at a time when some countries (e.g., Venezuela and Bolivia) have adopted closed statist economies.

- The U.S.–Uruguay Bilateral Investment Treaty would guarantee equal treatment for domestic and foreign businesses in both countries and boost bilateral commerce.
- The U.S. Senate should approve the treaty, both to strengthen bilateral ties and to show good faith to an ally that is pursuing sound economic policies.

Uruguayan President Tabaré Vázquez wants his country's economy to be strong enough to deliver prosperity and resist the periodic downturns that often plague its neighbors. The U.S. Senate should approve the U.S.–Uruguay BIT to strengthen ties between the two countries and show good faith to a longtime ally. Uruguayan officials have signaled that the BIT could lead to a full trade pact, which in turn could advance economic freedom throughout South America.

Why Uruguay? Wedged between giants Argentina and Brazil, Uruguay is the size of Iowa. However, it has the fourth highest gross domestic product per capita in Latin America and rivals Chile in effective rule of law, according to the *Index of Economic Freedom*, published by The Heritage Foundation and *The Wall Street Journal*. Transparency International rates it the second least corrupt country in Latin America.

Despite economic turmoil in the neighborhood, Uruguay has been a linchpin of stability. When Brazil devalued its currency in 1998, Uruguay continued to soak up Brazilian exports despite Brazil's contracting import market. During Argentina's 2001 economic crisis, Argentine capital initially sought safe haven in Uruguayan banks until Argentines drained their accounts to pay bills. Uruguay suffered a recession of its own from these events, but its economy rebounded within a year thanks to comparatively sound economic policies.

Yet Uruguay gets little respect from its bigger neighbors. To boost commerce and jobs, Uruguay plans to build a $1.8 billion paper mill on its side of the Uruguay River bordering Argentina. Argentina initially did not object, but as the project advanced, Argentine authorities allowed mobs to block commercial traffic crossing into Uruguay. They claimed that the mill would pollute the waterway even though, according to a report cited in the *Latin Business Chronicle*, many Argentine mills do not meet similar required environmental standards. Uruguay tried to settle the issue within the Southern Cone Common Market (MERCOSUR), but Brazil sided with Argentina,

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enabling Argentina to sue Uruguay in the International Court of Justice. Such episodes are not uncommon in the bloc.

Chomping at the BIT. MERCOSUR's formation in the early 1990s precipitated an impressive initial expansion of internal trade, but this turned around from 1998 to 2004, when trade declined by nearly 15 percent. During this period, Brazil shifted 30 percent of its purchases to non-member states, forcing partners like Uruguay to look for other markets.

Against this backdrop, U.S. and Uruguayan diplomats began talks on a bilateral investment treaty that would guarantee equal treatment for domestic and foreign businesses in broad commercial sectors and establish protocols to redress commercial grievances. MERCOSUR's charter prohibits full members, such as Uruguay, from going further by, for example, negotiating lower tariffs (e.g., free trade agreements) with non-member countries on their own. U.S. and Uruguayan representatives signed the final business pact during the Americas Summit in November 2005, and Uruguay's General Assembly ratified it on December 28.

Free Trade Shocker. Uruguay's interests go beyond bilateral investment, however. After taking office in 2005, President Vázquez publicly stated that MERCOSUR "as it is" is "of no use to Uruguay." In January 2006, his pragmatic Economy Minister Danilo Astori suggested a U.S.–Uruguay free trade pact. Other cabinet members denied it at first, but even Agriculture Minister José Mújica, a former Tupamaro guerrilla, reportedly said, "We must sign trade agreements with the United States, China and as many countries as possible, without turning our backs on the region."

Leaving MERCOSUR and forging free trade links with a host of other nations could open new markets for Uruguay and further strengthen its economy, and the threat of such a move could force MERCOSUR to scrap restrictions on full members making outside trade deals like the free trade agreement that associate member Chile concluded with the United States in 2003. Such a development could boost hemispheric trade and increase the likelihood of establishing the hemispheric Free Trade Area of the Americas (FTAA). On May 5, 2006, Vázquez met with President George W. Bush in the Oval Office to talk about such possibilities.

What the U.S. Should Do. Ratifying the U.S.–Uruguay Bilateral Investment Treaty is a "must." The agreement does not change any U.S. law and is clearly in America's interest. Uruguay is a longtime democratic ally that contributes peacekeeping troops to the United Nations and cooperates on international conventions to combat terrorism and drug trafficking. It has also backed U.S. initiatives on free trade such as the 1990 Enterprise for the Americas Initiative and the FTAA, now under negotiation. Uruguay's General Assembly has already approved the BIT, with the Chamber of Representatives voting 84–0 in favor.

Moreover, Uruguay's current socialist government shows that the state can still help the poor without reverting to the authoritarianism, repressive state controls, and politics of hate that characterize the retrograde regimes in Cuba, Bolivia, and Venezuela. Instead, Uruguay is helping the poor by investing in opportunities for all to share. If for no other reason than to reward sound policies and consolidate alliances, the Bush Administration should welcome Uruguay back to the negotiating table if it decides to pursue a free trade agreement with the United States.

Conclusion. Still willing to salvage MERCOSUR, President Vázquez stopped in Mexico to see President Vicente Fox before arriving in Washington. He asked trade-friendly Mexico to consider joining the South American customs union to make it "a better and more balanced bloc." Despite perceptions that a "pink tide" of leftist governments are taking over in Latin America, signs like these show that the United States has democratic allies of many shades with whom it can do business.

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