Free Trade Agreements between the United States and Latin America: A Test of Globalization

Carnegie Endowment for International Peace

March 14, 2006

Remarks by

The Honorable Sander M. Levin (D-Michigan)

Ways and Means Committee

In preparation for the trade agenda this year, I decided to go on a week-long fact-finding trip in late January to Peru and Panama. The Administration had notified Congress of its intention to sign a Free Trade Agreement (FTA) with Peru on January 6th and the negotiations with Panama were entering their seventh round. Since my trip, the Administration has also notified Congress of its intention to sign an FTA with Colombia.

I believe that trade agreements between the U.S. and Latin American nations represent an important test of globalization.

Working with U.S. and Peruvian and Panamanian government officials as well as private sector officials, NGOs and individual citizens, I was able in my four days in Peru to hold a broad range of two dozen meetings with governmental leaders, the business community, labor organizations, religious groups, civil society, and international organizations. A similar breadth was true for a smaller number of meetings during my two-day stay in Panama.

The discussions focused on the impact of rapidly expanding economic globalization on their socio-economic structures, the level of economic growth and its contents, and the likely effects of an FTA embodied in the negotiations between our nations.

The size of the trade between our nations is, of course, not the driving factor for the U.S. in determining the significance of these two FTAs. In quantitative terms, Peru and Panama represents less than 1% of total U.S. trade The perspective of Peru and Panama trade statistics on this front is quite different, with 26% of total Peruvian exports in 2002 and 50% of Panamanian exports in 2004 going to the U.S.

The significance of our relationship with those two nations extends beyond these quantitative trade figures. They are in a region close to us geographically and with important historical ties to our nation. They are democratically-elected governments with a coterie of well-trained officials including two Presidents who themselves have been trained in the United States. We have important national security concerns with the Panama Canal and with the flow of dangerous drugs, namely cocaine, to our nation.

But I believe there are also larger considerations that make Peru and Panama, as nations in Latin America, useful test cases of globalization.

First, the tide of international trade and competition is changing and the challenge is now increasingly in the competitive relationships between already economically-developed nations as our own, and developing nations with very different economic structures than our own.

Second, the heightening political, social, and economic turmoil in Latin America has moved it up on our radar, and our television screens, forcing the public and policymakers to ask, "what is going on?"

Third, and importantly, the combination of economic growth in Peru and Panama and the persistent poverty and income inequalities challenges us to answer a basic question: Is a focus on economic growth through expanded trade, in and of itself, a sufficient approach to the challenges facing these nations? Or must there be broader focus on the terms, the contents, and the impact of the flow of goods and services and how trade agreements can be shaped to leverage expanded trade to benefit a broader range of citizens?

Economic Growth and Persistent Poverty

Economic growth is palpable in Lima and Panama City. Tall new office and residential buildings rise above loads of cars jammed on modernized highways. With this dramatic urbanization, Lima has grown rapidly with a present population of 8.27 million, one third of the population of Peru. Panama City has a population of 1.1 million, roughly one third of the entire nation.

Annual growth in each country has been over 6% and inflation under 4% for 6 years. According to IMF data, in 2005, Peru had the lowest inflation rate in Latin America (1.8%), followed by Panama (2.6%). The IMF projects that in 2006 Panama will likely register the lowest inflation rate in the region, at 1.8%.

Their economies also have major differences.

Peru has a larger industrial sector, large mining industries reflecting its significant natural mineral wealth, and an important apparel and textile industry reflecting its alpaca and fine cotton resources. While so much of Peru is arid, it has important agricultural areas that combine considerable farming of subsistence products, such as rice, sugar cane, potatoes and maize, plus fruits, which are an important source of exports, as are the asparagus and artichokes processed in growing agribusinesses in several coastal areas. Coffee is also produced for export. The Peruvian economy has been bolstered by the increasing demand for its minerals. Peru is the world's second largest producer of silver and the sixth largest producer of gold and copper.

Panama's economy revolves predominantly around financial and other services. Agriculture remains central in several areas of the nation.

Increased trade has clearly played a role in the growth in both economies: in services for Panama and in the lowering of tariffs under Andean trade preference programs, which I actively supported, for Peruvian exports of apparel as well as its agribusiness exports of asparagus and artichokes and fruits. The production of these exports on the Coast away from Lima has brought about a beneficial decentralization of the economy. Shortly after I met with the Peruvian Trade Minister, he went to a press conference to announce an increase in Peru's annual trade surplus figures.

While there is clearly considerable wealth in both nations, there is also visible evidence of the persistent poverty in which the majority of the population lives.

Recent estimates are that about 50% of the population in Peru lives in poverty, defined as under $58 a month, and about 20% in extreme poverty, defined as under $32 a month. In Panama 40% of the population lives in poverty.

In both nations, there are huge disparities in the distribution of wealth and income. Income inequalities are wider in Latin America than in any other region on the globe. Indeed, a 2004 report entitled "Social Panorama of Latin America 2004" published by the Economic Commission for Latin America (ECLAC or CEPAL in Spanish), which is one of five regional commissions in the United Nations, states that:

> "{T}he marked degree of income concentration is one of the hallmarks of Latin America's panorama. This has earned the region the dubious distinction of being the most inequitable region on the planet in terms of income distribution, even when compared with less socially developed regions with higher poverty rates."

The report goes on further to note that:

> "On average, households in the . . . poorest 40% receive about 13.6% of total income" and that "the richest decile takes in an average of 36.1% of all household income in Latin American countries . . . ." The report also states that "{t}he high percentage of resources concentrated in the richest decile is a distinguishing characteristic of Latin America."

This reality is true in both Panama and Peru, and reflected in the World Bank's most recent World Development Indicators, which are based on 2000 data. In Panama, the richest 10% of the population receives 43% of the income, while the bottom 10% receives only 0.7% of the country's income. In Peru, the richest 10% receives 37% of the income, while the bottom ten percent receives only 0.7% of the country's income.

On the ground in both of these countries, I found strong opinions on the question of whether economic growth in and of itself was the basic key to address the economic and social development needs in both countries and significantly reduce the persistent poverty and income disparities.

Economic Growth and the Role of Workers

Virtually everyone I spoke with in Peru as well as Panama spoke of reducing poverty as the top priority. President Toledo was particularly eloquent on this need.

In a number of meetings within the business world, whether industrial or export trade associations, or leading economists and other consultants close to the business community, there was a common answer to the reduction in poverty: overall growth. There was a frequent reference to the need for jobs in the formal sector so that the 60% of Peru's economy operating outside of it could be brought in. The informal sector consists of individual sales work, subsistence agriculture, peddling and casual jobs – work that falls outside of a country's legal or regulatory framework.

One consultant to businesses put it tersely, ". . . simply don't worry about conditions in the formal sector, the task is to have the estimated 7 million who are working in the informal sector join the estimated 2 million working in the formal sector." There, he said, "they would be working in established structures, working under conditions subject to laws and the social security system." There was a similar tone in meetings with some government officials. The basic equation, even while acknowledging other factors like a weak legal system, insufficient foreign direct investment and corruption, reads: economic growth producing jobs equals major reductions in poverty. Interestingly, when I posed this economic growth argument to one Panamanian business consultant, he said that he had seen very little economic "trickle down" to the general population.

Woven into this common analysis about economic growth were statements about the position of workers in the formal sector. Peruvian laws, including reforms of 2002, were described by people in the business world and government officials as consistent with basic international standards on the rights of workers. I heard statements like "fully compliant," or the ILO says "no real problems," or even Peru is an "overachiever" when it comes to international labor standards.

When I met with two representatives of the International Labor Organization (ILO), working in the Lima office, I asked whether workers in Peru possessed their international worker rights in law and practice. The answer was a clear and precise "no."

The ILO reports, as well as those of the State Department, document the failure of Peru's laws to comply with the five basic ILO standards (prohibitions on child labor and forced labor, non-discrimination, and the rights to associate and to bargain collectively) in five areas and expressed concern about four additional areas. Problem areas include a failure to prohibit in their laws employer interference in union organizing and anti-union discrimination, the inclusion in their laws of a provision permitting employers in certain circumstances to unilaterally change collective bargaining agreements, the use of temporary workers to thwart union activities, and strike requirements that make it difficult for workers to exercise this right. Complaints filed with the ILO in recent years highlight both the deficiencies in Peruvian laws as well as inadequate enforcement of the laws that do exist.

What is not fully captured in all of the documents and what was not evident to me before I went to

Peru was the impact of the legal structure and practices introduced during the Fujimori regime that persist today. This was etched in a broad range of meetings with religious leaders, civil society and worker representatives. In the government prior to the election of Fujimori, there was the introduction of some laws intended to regulate hours of work that went well beyond regulating hours. These rigid labor market controls, for example, made it very difficult to fire an incompetent worker. Instead of addressing these specific problematic provisions, the Fujimori regime turned aspects of labor-management relations upside down. It also created systems of "fixed-term labor contracts" and "sub-contracting" that continue to this day to dramatically undermine workers' rights.

In theory, the current labor laws on freedom of association apply to these categories, but in reality any worker who chooses to exercise his or her right to join a union is easily thwarted by the employer, who simply does not renew the temporary contract or the sub-contracting agreement. Another problem is that there are a number of different laws on hiring and contracting labor that are regulated through commercial and civil codes. Examples of these types of laws include the *Law of Productivity and Labor Competitiveness* (Ley 728), which established new forms of labor contracting, and the sub-contracting, or *"Labor Intermediation"* law (Ley 27626), which defines the conditions under which a company can contract the provision of labor to a service company. Because workers can be hired under such employment configurations, in practice they are not protected by the legal framework of the labor code.

There were discussions indicting that the use of these laws was increasing.

In the mining industry, representatives of mine workers told me that before the wide-spread implementation of sub-contracting and the formation of service cooperatives, there were 70,000 workers employed in the mining sector under regular full-time direct contracts. Approximately, 45,000 were organized in unions and enjoyed collective bargaining agreements. Today, they said only 17,000 have regular, full-time, direct contracts – these individuals belong to a union and have collective bargaining agreements. The conditions for the roughly 75% working under sub-contracts have declined as well with many working 12-14 hours a day, for two weeks straight.

A similar story was told to me by workers in the communications field where roughly 50% of the workers in the land-line telecom sector are sub-contracted and union memberships has fallen by 75% in the last ten years from 12,000 to 3,000 members.

While I did not have the opportunity to meet directly with workers in the agribusiness export areas located primarily on Peru's coasts, I did meet with organizations familiar with these conditions. At the same time, the combination of inadequate laws, the sub-contracting issue, and weak enforcement, make conditions in this area very harsh for the workers. A major daily newspaper, *La Republica*, described vividly in a November 2004 article the plight of asparagus workers – primarily single mothers – working under extreme sun exposure without hats or glasses with cuts on their un-gloved hands. These workers described 10-14 hours, 6 day work weeks, no vacations, no health benefits and very low wages ($5.30 a day) that dropped if demand for the crop dropped. They also described the same situation of sub-contracts, the firing of union organizers, and the fact that labor inspectors had never visited or inspected the conditions despite worker complaints.

According to one of the groups I met with in civil society, Centro de Asesoria Laboral del Peru (Peruvian Center for Labor Support), in the City of Ica there was a study of 48 of the 62 agribusinesses and only four were found to be meeting legal requirements. In the asparagus industry, there is one union that has been recently organized. The union has several hundred members on a farm employing 1,000, but no collective bargaining has taken place. It remains to be seen whether the union members will be able to avail themselves of the laws and regulatory system to improve conditions.

When President Toledo of Peru visited Washington last fall and met with Members of both parties on the Ways and Means Committee, he expressed the view that if globalization was going to work there must be a broader sharing of the benefits of expanded trade. He stated that if that was to happen workers must be included, and to accomplish that inclusion the basic international standards should be incorporated in the trade agreement.

I believe that consistent with this view were two starts during the first years of the Toledo Presidency.

First, the Peruvian government asked for the assistance of the ILO in preparing a national plan for decent employment. A preliminary report written in 2003 and entitled, "Proposal for a National Program of Decent Employment" was presented to the government, and representatives of employers and workers. This effort seemed to stall as the FTA negotiations started, according to people that I met with during my trip.

A second initiative continued by President Toledo is a "tripartite commission" of business, labor and government to see what steps could be taken beyond the labor law changes of 2002. While progress was made on some issues, the effort has been in stalemate for several years. It has been unable to reach consensus on some fundamental issues including the need to consolidate the labor code, key issues relating to the rights essential for workers to participate in determining the terms and conditions at the workplace, and better regulation of sub-contracting, temporary contracting, and inspections.

One cannot glean an entire picture in four days, even with intensive hours of highly diverse meetings, but what I learned reinforced in my mind the problem with the insistence of the Administration in negotiating a standard for workers rights that they would never dream of using in any other section of the FTA: that a country must simply enforce its own laws. And the laws can be made worse with impunity.

In a setting and at a time when there is increasing need to address poverty and economic inequalities by combining policies of growth directly with key elements of equity <u>it places us on the wrong side.</u>

For the large numbers of impoverished people within Latin America, it places us on the wrong side.

At a time when there seems a movement to open the lens on the controversy that has swirled about the need to expand trade and the role of worker rights, it places us on the wrong side.

A recent report of the World Bank on Latin America, entitled "Poverty Reduction and Growth: Virtuous and Vicious Circles" possesses quite a different tenor than the notion, often echoed within the Administration as well at times in the World Bank and elsewhere, that trade expansion is "win-win" – more trade is always better no matter its content, its terms or its flow.

After an opening reference to "Latin America's twin disappointments of relatively weak economic growth and persistent poverty and inequality," and amidst immense technical detail and caveats, there is this paragraph in the report:

> "On the whole, the previous discussion suggests that a sensible development strategy should focus both on the quantity of growth (that is, on the achievement of a high growth rate) and on the quality of growth (that is, on the benefits from that growth)."

The report goes on to say:

> ". . . unfortunately, this general advice is not very useful for policy purposes. For one thing, the achievements of both growth and a more equal income distribution are policy outcomes that are a challenge in themselves. But beyond that, the discussion leaves unanswered a number of questions of extreme relevance for policy making."

I believe that the "general advice" is highly useful regarding the role of workers rights. They are one piece of the overriding issues of the "quantity" and "quality" of growth. It is one area where history in innumerable nations provides evidence that the enhancement of rights and the role of workers can vitally affect the "quality" of growth.

The Bush Administration has fought efforts to place in trade agreements a requirement that there be adherence to the basic ILO standards with a reasonable transition period.

There have been shifting arguments by the Administration as to their opposition to ILO standards and inclusion in the trade agreements of a standard of "enforce your own laws":

- An early argument, workers' rights or labor market conditions are "social issues," soon fell to the reality that labor market conditions are important and sometimes controversial precisely because of their economic nature; our own history illustrates that workers joining together on the factory floor to improve their economic status helped to build the U. S. middle class.

- The U.S. should not "impose" its standards or labor-management issues on other nations. The weakness of that argument often heard in the debate over the terms of a TPA was that no one was ever talking about American standards, but rather the five basic standards of the ILO. And trade agreements as a contractual understanding by definition "impose" conditions, whether reduced tariff levels, increased protection of intellectual property, or opening-up of competition in financial, insurance, or other services.

- The problem is not the laws themselves, but mainly technical issues of enforcement and the need for more capacity to enforce. In the debate over CAFTA, the five nations put together a book, *"Building on Progress: Strengthening Compliance and Enhancing Capacity,"* known as the "White Paper," detailing their plans to improve their labor laws through enforcement, but not to address any shortcomings in those laws. This ran counter to the 21 specific areas in which the ILO and State Department reports had found the laws to be out of compliance, and ignored the reality on the ground, which was clearly one of suppression of the basic rights of workers.

- The most recent effort to justify the U.S. position was articulated by Ambassador Portman in a letter to Ways and Means Democrats. The incorporation of the five basic international standards in trade agreements could subject U.S. labor management laws to vague standards that could find our own laws out of compliance. While agile, this position dismisses the fact that there are plenty of examples of provisions in trade agreements that need to be interpreted through implementation and practice, and ignores the fact that any complaint regarding alleged violations of ILO provisions on worker rights under the FTA would have to be shown to be "directly related" to trade between the two countries and could only be filed by the other government. That is highly unlikely in our bilateral and regional FTAs where the balance of need for expanded trade is on the other side and the balance of economic power is on our own.

The adamant resistance of the Administration no doubt stems partly from the belief of some within it that economic growth is all that really counts, that growth itself will resolve issues of poverty, and essentially irrelevant are imbalances of distribution of income. Others seem to carry into international trade negotiations their view of labor-management issues in the U.S.

What I believe urgently needs to be understood is that the shortcomings of these approaches has special relevance for Latin America and our important relationships with these nations and their people.

In most of the nations of Latin America the majority – often the vast majority – of the population is impoverished. They feel on the outside looking in. Globalization is increasingly resisted because so many people are not sharing in its benefits, including the benefits of expanded trade. It is one of the sources of the appeal of populists. Populism thrives when those conditions are not widely shared among a nation's population.

In negotiating trade agreements, the U.S. should not be locking in the status quo, but given constructive opportunities, helping to leverage change. The use of the standard "enforce your own laws" in relationship to workers and their rights, when change is vitally needed, puts us on the wrong side of people who know current laws are not working to their benefit.

We want to encourage participation in the structures of these societies, starting in the workplace where one might collectively impact one's economic status, rather than sanctioning a system that discourages such participation. Indeed, we are seeing over and over again, the impact that a lack of participation in reaping the benefits of globalization has in causing participation to boil over to the streets of this region in protest of the status quo.

Economic Growth and the Small Farmer

While I was in Peru it appeared that there were still a few details to be worked out on the agricultural provisions of the FTA, and it did not seem that the text of any of them was available to the public. It is now clear from the published text that the FTA will lead to still further growth both in Peruvian and American exports.

Peruvian agricultural exports have blossomed in recent years. Under Andean trade preference programs, the major growth has occurred in asparagus and artichokes, where there is some competition with the U.S. It has also happened in fruits with less competition because of the seasonal complementarities.

Lower Peruvian tariffs will clearly help Peruvian consumers in areas where there is no major source within Peru. That was vividly illustrated in a meeting with two entrepreneurs who had proudly as young sisters started to develop into a major enterprise the importing of lentils and peas. Their business could grow still further without the burden of a 25% tariff.

In a variety of meetings I discussed the potential impact of the FTA on Peruvian farmers. About 30% of Peru's population are farmers, the vast majority growing subsistence crops including corn and rice as well as cotton, dairy products and beef. These types of crops and products, many of which are subject to less external competition by a network of price bands, are grown on about one-half of the land under cultivation.

It was clear that under the FTA there was going to be a reduction of tariffs on imports from the U.S. of these products, although precise details were not always known.

As was true about what the FTA would mean for workers, it also was striking how polarized the reactions were about the likely impact on the large numbers of small Peruvian farmers.

"Some studies have greatly exaggerated the impact" was a view offered by one of the business consultants. One government official suggested that "the impact overall would be positive."

One government official urged that the provisions on agriculture were "over-all positive." Another, while describing the FTA as a "win-win" proposition, said that the Peruvian Government has been developing a program to compensate small farmers for their losses.

The reaction was quite different in meetings that I had with groups in civil society, including faith-based groups working in rural areas, where they expressed considerable concern. Concern was still higher in an extensive meeting with nine representatives of corn, rice, dairy, potato, irrigation and coffee associations belonging to the organization, Conveagro.

They said that they were not opposed to any FTA. But, as to the one being negotiated, even though some had indicated a willingness to be engaged in the process at the outset, they had not been involved in any meaningful sense. They all shared the view they could not compete with subsidized American crops. And while they knew the FTA would contain transitional provisions, including tariff rate quotas, they were concerned about what they contained, the shortness of the transition periods, and how sufficient and reliable any announcement of governmental compensation programs would be for dislocated small farmers.

One of the Conveagro participants said that "globalization is like a big current of water. Don't swim against it, but if you are in it, you're still likely to drown."

In Panama, according to the U.S. State Department, and based on 2004 data, agriculture represented 6% of GDP, which is quite small in comparison to the service industry, which represented 80% of GDP during the same time period. Panama's agricultural products include bananas, corn, sugar, rice, coffee, shrimp, and livestock. But, as I learned during my trip, it is very important to the lives of many people and remains one of the unresolved sensitive issues in the negotiations. The sensitivity of the agricultural issues was demonstrated when the Agriculture Minister of Panama resigned in protest against his Government. The two governments have been disagreeing over the administration of Sanitary and Phytosanitary (SPS) regulations. From my meetings in Panama, it is clear that our government believes, especially in view of the strength of American standards, that the SPS issue is being raised at least in part to minimize the impact on small Panamanian farmers from other provisions.

Before leaving for the trip, I had read a study issued six months ago by the Carnegie Endowment on U.S. negotiations for a free trade agreement with Andean nations. It stated, based on its interviews with leaders and analysts, that expanded trade would have an "unambiguous positive impact" on some of the economy and population, and that " . . . {t}he brunt of the adjustment costs are likely to fall on farmers and the rural population in the Andean countries."

As I left Peru and Panama, I felt that this warning needed to be seriously considered.

It reinforces the need that as trade expands, it is also vital in this sector that one looks beyond the gross amounts of flow to the nature, contents and potential impacts of the flow. In view of the existing circumstances, we need to expect that there are two sides to the equation. If we fail to do so, we are likely to end up on the wrong side, a result we can ill afford in Latin America.

The Carnegie Endowment has been doing some further intensive work on this subject and tomorrow there was be full descriptions and discussion of this work, which I am confident will shed some important light in this area and I hope will stimulate some needed dialogue regarding U.S. policy.

Conclusion: An Opportunity to Advance Trade Policy, Conditions in Peru and Panama, and the U.S. Relationship with Latin America

Beyond the value of seeing firsthand and talking to people directly involved, some of which I hope I have been able to share with you today, I find that I come away from a trip like this one with a better impression of the overall environment in which our countries are negotiating their economic relationships. Both in Peru and Panama, while there was a deep divergence of views, there was considerable civility. There was a universal expression that poverty reduction is goal number one, and there was a genuine warmth among the people of Peru and Panama towards the people of America.

This should enable us to end up with FTAs that both encourage overall growth and stimulate growth to work in ways that reduce poverty.

The Peru FTA should add to overall economic growth in both nations, including for the U.S. in crops and industrial goods. As emphasized in an American Chamber (AmCham) meeting in Lima, the FTA should also bring about qualitative gains in helping to create clear rules, greater respect for the law, and a more certain structure for settlement of disputes – all important for attracting investment.

During my trip and for a short-time afterward, I also found myself hopeful that we could have an FTA that helped to bring about workers' rights and participation that could impact poverty and income inequality. An FTA that responded to the impact on small farmers, and an FTA that ensured access to needed medicines. This type of FTA that would put us squarely on the side of <u>all</u> the people of Latin America.

This is an opportunity that is being missed and why I cannot support the FTA as presently drafted.

The opportunity remains.

It cannot materialize if there is a resort to the reflexive claims of "protectionism" when those of us who lead in raising issues have a record of helping to develop key trade agreements, or cries of 'isolationism" against members with a record of internationalism.

I believe that we have the opportunity to take the debate to a higher level, and help to rebuild a bi-partisan foundation for trade so fully needed in these days of highly thorny global trade issues.

We have an excellent opportunity based on mutual interests. The development of a middle class is critical for Peru, for their citizens wanting to climb out of poverty, for our workers who do not want to compete against workers lacking basic rights and for our businesses who need middle classes to buy their products.

And, now with the invitation last week of President Toledo to the full Ways and Means Committee to travel to his country in the immediate future, we have the ability to take advantage of these opportunities. Such a trip pursued with open minds, and designed to engage the diversity of views, could bring about a common understanding among our two parties on the overall issue of whether growth must be combined with steps to address the "quality" and "equity" of that growth and specifically on the role of workers and international labor standards in shaping the economic conditions.

It was said to me in Peru that in part the problem was our policies in Washington.

I hope we can prove that view wrong.