The Heritage Foundation
Executive Memorandum
214 Massachusetts Avenue, N.E., Washington, D.C. 20002-4999 • (202) 546-4400 • http://www.heritage.org
No. 800 February 8, 2002

Why the President Should Sign a Free Trade Agreement with Uruguay

Ana I. Eiras

When Uruguayan President Jorge Batlle visits Washington on February 15, President Bush will have an opportunity not only to offer to sign a free trade agreement with one of America's allies in Latin America, but also to send a strong signal that America is committed to helping all of its allies in the region to prosper.

The recent Argentine economic crisis presented new challenges for U.S. policy toward Latin America. Though Argentina had implemented some economic reforms to open its markets, it failed to make the institutional changes needed to ensure that those reforms took root. Consequently, if the crisis in Argentina continues, some critics of free-market principles in other countries may try to push for a return to protectionist, leftist policies.

To encourage Latin countries to open their markets fully, the United States should advance free trade with countries that have already demonstrated a commitment to economic liberalization. While Chile is the primary candidate and is currently negotiating an agreement with Washington, Uruguay should be next in line. Equally important, the Administration should use this opportunity to reassert its leadership on trade throughout the hemisphere.

Uruguay as a Model of Reform. Uruguay, much like Chile, is a model of reform for the rest of the region. It has opened its markets slowly but consistently since 1974 and has established a strong rule of law to preserve those reforms. Throughout the past 20 years, according to the World Bank, real per capita income has grown over 60 percent. In 1999, Uruguay was ranked second among Latin American countries in the U.N.'s *Index of Human Development*, according to the Economist Intelligence Unit 2001 profile. Most important, Uruguay's economic reform trend survived leftist rulers and regional economic crises.

By signing a free trade agreement with Uruguay as well as with Chile, the United States would give other Latin leaders who advance free-market reforms a strong incentive to continue. Most of Latin America enthusiastically implemented several free-market reforms in the 1990s, including privatization, price liberalization, inflation control, and deregulation of foreign investment codes. As a result, foreign direct investment (FDI) in Latin America increased rapidly, more than doubling from 1991 to 1995. The growth in investment raised living standards and lowered poverty in many parts of the region by promoting job creation,

Produced by the
Center for International
Trade and Economics (CITE)

Published by
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/execmemo/em800.html*

improving the quality of products and services, and lowering prices. Regrettably, however, that prosperity, though real, was unsustainable because most of these countries lacked the rule of law. Without it, there is always a possibility that policymakers could undo critical reforms.

Establishment of the rule of law is what distinguishes Uruguay and Chile from the rest of the region. Uruguay has made substantial progress in shedding its social welfare and import substitution policies of the 1960s. According to a report from CERES, a Uruguayan think tank, the country began reforming in the mid-1970s, liberalizing capital markets and eliminating restrictions on repatriation of funds, interest rates, and the exchange rate. Throughout the years, it unilaterally has lowered trade barriers, eliminated price controls, and increasingly provided equal treatment of foreign and domestic companies in various sectors.

Unlike most other Latin countries, however, Uruguay also has fostered a strong rule of law, enabling the reforms it implemented to remain in place regardless of the ideological position of successive governments. Today, according to an April 2001 Economist Intelligence Unit report, "contractual agreements are secure in Uruguay [and] verdicts are usually based on sound legal grounds." A strong rule of law has made Uruguay a predictable place and a magnet, for example, for much of the capital leaving Argentina.

Latin America's free-market experiment has not yet succeeded because countries opened some of their markets without strengthening the rule of law—the only guarantee that reforms would last. Thus, the current economic and political crisis in Argentina could repeat itself in such countries as Bolivia, Peru, Paraguay, Ecuador, Brazil or Colombia, where the implementation of free-market reforms has been partial and the rule of law weak.

How Trade with Uruguay Advances Reform in the Region. The other countries of Latin America are at a critical point in the reform process, and unless they open their markets sufficiently and reform their institutions to protect their reforms, they may face their own crises. There is no better time for United States to advance free trade in the region, beginning with countries like Chile and Uruguay that already have opened their markets and instituted the rule of law.

The Administration is currently in negotiations with Chile; Uruguay should be next. Signing these agreements would demonstrate America's commitment to its allies and encourage other Latin leaders to follow the Chilean and Uruguayan examples. To this end, the Bush Administration should:

- **Finalize negotiations with Chile on a trade agreement**. These negotiations have progressed smoothly. Both countries are addressing the issues of concern, including labor and environmental provisions and market access for their most important products. To proceed more quickly, the President needs trade promotion authority (TPA), which will assure Chile that the agreement will not be tied up in Congress in the amendment process. The House has already approved TPA; the Senate should follow suit.
- **Offer Uruguay's President a free trade agreement**. A free trade agreement with Uruguay would be a strategic move to advance economic reforms in Latin America. For many, the trade agreement with Chile is simply the fulfillment of a promise the United States made in 1994, not a step that advances trade in the region. Signing an agreement with Uruguay would reaffirm the Administration's commitment to support those who share America's principles and unilaterally implement reforms by offering them access to the world's largest market. An agreement with Uruguay would send a strong signal to the region that America is committed to helping its allies prosper and that those who make real reform will be rewarded.

Conclusion. Latin America has made limited progress in opening its markets, but further reforms are threatened by the inaccurate perception that free-market policies by themselves led to Argentina's crisis. To encourage Latin countries to continue liberalization and to strengthen the rule of law, the President should take this opportunity to sign a free trade agreement with Uruguay, a country that has already demonstrated its commitment to free-market policies and institutional reform.

—Ana I. Eiras is a Latin America Policy Analyst in the Center for International Trade and Economics (CITE) at The Heritage Foundation.