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AMERICAN ECONOMIC POLICIES TOWARD MEXICO AND LATIN AMERICA

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

SEPTEMBER 17, 1990

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SUBMISSION FOR THE RECORD

MONDAY, SEPTEMBER 17, 1990

AMERICAN ECONOMIC POLICIES TOWARD MEXICO AND LATIN AMERICA

MONDAY, SEPTEMBER 17, 1990

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to notice, at 10:38 a.m., in room SD-628, Dirksen Senate Office Building, Hon. Paul S. Sarbanes (vice chairman of the committee) presiding.

Present: Senators Sarbanes, Symms, and Graham.

Also present: Stephen Quick, chief economist.

OPENING STATEMENT OF SENATOR SARBANES, VICE CHAIRMAN

Senator SARBANES. The committee will come to order.

The Joint Economic Committee today is holding a hearing on American Economic Policies Toward Mexico and Latin America. The United States has clearly embarked on a search for a new way of relating to the nations of Latin America. Increasingly, Americans are recognizing that international economic relationships are the cornerstone of future relations among nations. If we are to forge genuinely constructive new relationships in the hemisphere, we must ground these relationships in an improved climate of regional economic development.

In terms of economic performance, the decade of the 1980's has been a disaster for most of Latin America. Recession in the United States followed by falling commodity prices and an end to voluntary bank lending threw much of the region into a slump from which it has yet to recover fully. In response to this economic crisis, U.S. policy for much of the decade offered little more than advice on how to adjust to declining living standards and a deteriorating international environment.

Over the past year or so, however, there have been encouraging signs of new thinking on U.S. economic policy toward the hemisphere. In the financial area, the Brady plan represented a major breakthrough by accepting the principle of debt reduction, a principle which now may be extended to official bilateral debt as well as commercial bank debt. In the area of trade, the anticipated negotiations with Mexico on a free trade agreement represent a first concrete step toward implementing a broad trade liberalization agenda outlined in the President's Enterprise for the Americas initiative.

Those of us in the Congress who have been concerned about deteriorating economic conditions in the hemisphere welcome these new initiatives, and are looking forward to hearing from today's witnesses some additional details on the administration's plans for the hemisphere.

As we contemplate new economic policies toward the hemisphere, however, I believe we should keep four issues in mind as we work to develop a new pattern of sound and lasting economic relationships in the hemisphere.

First, any new pattern of economic relations must ensure the mutuality of benefits. A plan which concentrates all or most of the economic gain in one party, and all or most of the economic sacrifice in another, cannot be expected to endure.

Second, any new economic vision for the hemisphere must be predicated on an assumption of strong growth in the Latin American economies. Countries with youthful populations and rapidly growing labor forces cannot maintain the necessary degree of social and political stability without a rate of growth sufficient to provide employment for a large fraction of new labor market entrants. Rapid growth is also essential to maintain a balance in trade between the countries of the hemisphere.

Third, to the extent that regional economic relations are based on a lowering of trade barriers, it is important that careful thought be given to coping with the dislocations which such changes will inevitably bring about. The possibility of a free trade agreement with Mexico, for example, would represent the first such agreement between an advanced industrialized country and a middle-income developing country. The United States-Canada Free Trade Agreement proved technically and politically complex, even though the two countries, the United States and Canada, shared a common income level, and common labor and product standards.

In Europe, income disparities between EC members are significantly greater than between the United States and Canada, though much smaller than between the United States and Latin America. Acknowledging that these differences create potential dislocation problems, the EC has made a major commitment to ease dislocation through regional development funds and through the formation of common social standards to prevent economic integration from leveling both wages and social standards down to the lowest common denominator.

While the United States need not adopt the European example to the problems of dislocation, it is important that substantial effort be made toward building the domestic support for a broad hemispheric trade initiative.

Finally, steps to improve the economic integration of the hemisphere must also confront the issue of environmental sustainability in economic development. The fact that environmental issues have been at the top of the agenda at the last two international economic summits is testament to the growing need to place environmental and economic interests at the same level when negotiating bilateral, regional, and multilateral agreements. We can no longer afford to separate the consideration of environmental issues from the consideration of trade and economic development issues, as those who have been dealing with the pollution problems along the United States-Mexico border can readily document.

With these issues in mind, let me now welcome our panel of witnesses from the administration to explore these issues in greater depth.

We are very pleased to have with us this morning Mr. David Mulford the Under Secretary for International Affairs, at the Department of the Treasury; Mr. Roger Wallace, Deputy Under Secretary for International Trade at the Department of Commerce; and Ambassador Julius Katz, Deputy Assistant U.S. Trade Representative.

Ambassador Katz is filling in for Ambassador Hills at a meeting at the White House this morning, and he will be along later, but we will proceed now to hear from Under Secretary Mulford and then Deputy Under Secretary Wallace.

Mr. Mulford, we would be happy to hear from you.

STATEMENT OF DAVID C. MULFORD, UNDER SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS

Mr. MULFORD. Thank you, Mr. Vice Chairman, and thank you for the opportunity to discuss the proposed free trade agreement (FTA) negotiations with Mexico, in the context of the wider Enterprise for the Americas initiative announced by the President on June 27. We look forward to full consultations with you during your review of these initiatives.

The FTA proposal reflects the emerging global recognition that open markets for trade and investment are a powerful impetus for growth. We must not underestimate the magnitude of this change in perception. Just a few years ago, there was no such basic consensus except perhaps in the financial markets which as we have seen already have undergone a rapid globalization. In the trade area FTA's and other far-reaching trade and investment agreements seemed, at best, a long-term possibility.

Now we have an FTA with Canada, we are preparing to initiate negotiations on an FTA with Mexico, and we are pursuing other far-reaching trade and investment agreements in the President's Enterprise for the America's initiative and in other parts of the globe.

Mexico is in the forefront of this shift toward more open, market-oriented development strategies. Its courageous steps to stabilize the economy and its structural reform program have put it on the path of long-term sustainable growth. Its great potential as an economic partner of the United States is in sight. Now is the time to create a permanent economic relationship based on open markets.

We have an opportunity to do so in a manner which consolidates current progress and promotes further reforms.

BENEFITS FOR THE UNITED STATES

Growth in trade and investment through an FTA can be an important stimulus to U.S. growth. Already expanded ties have benefited the U.S. border regions. But there is considerable potential for greater benefits to the United States as a whole if barriers to the United States-Mexican trade and investment are progressively eliminated.

As Mexican growth accelerates and investment picks up, demand for capital goods, machinery and transportation equipment, should respond quickly. U.S. industry, in part because of its significant presence in Mexico, is in a good position to fill much of this demand through increased exports.

In addition, as Mexico develops, demands for services should rise. The FTA can be an effective vehicle for ensuring that U.S. firms can compete on an equal basis in this growing market.

But the potential benefits for the United States are not just on a sectoral basis; an FTA can help improve our overall economic efficiency. The two countries already engage in a considerable amount of complementary intraindustry trade. Lower trade and investment barriers through an FTA can make U.S. industries more competitive by promoting further intraindustry specialization, capitalizing on each country's comparative advantage.

BENEFITS FOR MEXICO

In relative terms, the positive effect of an FTA, as well as the economic adjustment costs, will be considerably greater for Mexico than for the United States. This is because the expanded trade and investment flows will be much larger in relation to the Mexican economy, which is only 4 percent the size of ours.

For Mexico, improved export opportunities and a more open investment regime will likely lead to substantial foreign investment inflows for years to come. The Mexican Government estimates that at least $1 billion in capital inflows have already occurred since the announcement in June by the two Presidents of their intent to work toward an FTA and the announcement of Mexico's intention to privatize its commercial banks.

To some extent, this is a preview of the benefits that can flow from an FTA. Further liberalization under an FTA will solidify business confidence. The likely beneficial effect of this liberalization on Mexican economic efficiency and inflation will contribute to a positive economic environment. In the longer term, an FTA can also provide an important incentive for Mexico to maintain sound macroeconomic policies.

An FTA would strengthen Mexico's balance-of-payments position. Increased capital inflows should offset any short-term deterioration in the trade balance. In the longer term, import and direct investment increases will contribute to expanded capacity and strengthen international competitiveness.

WHY AN FTA?

Compared to a more limited trade agreement, pursuit of a comprehensive FTA is the best means to ensure maximum benefits from negotiations.

First, comprehensive FTA negotiations will produce a balanced agreement with commitments on both sides for mutually beneficial liberalization. We do not intend unilateral U.S. liberalization.

Second, since the FTA negotiations will follow the Uruguay Round, these negotiations can build on new multilateral rules in such important areas as services and investment. The FTA could serve as one of a new generation of improved models for liberalization.

Third, an FTA is the most effective strategy for encouraging continued liberalization in Mexico, which is to our benefit as well as theirs. Mexico's trade barriers are already low by developing country standards. It has taken initial liberalizing steps in such areas as foreign investment regulation and financial services. We welcome such steps. But our ultimate goal in the negotiations will be the greatest possible liberalization for investors, including financial services providers.

LINK WITH THE ENTERPRISE INITIATIVE

An FTA with Mexico is fully consistent with our new, overall economic strategy toward Latin America, the Enterprise for the Americas initiative, which President Bush announced in June. That initiatve joins in a single endeavor the three economic issues of greatest importance to Latin America: trade, investment, and debt.

On trade, the ultimate goal of the initiative is to establish a free trade system which links the entire Western Hemisphere. FTA negotiations with Mexico are a major first step. Others will follow. We are already negotiating framework agreements to open markets and develop closer trade ties with several countries.

On investment, the initiative includes two specific proposals which can create incentives for Mexico and other Latin American countries to liberalize their investment regimes:

First, a new lending program in the Inter-American Development Bank to support investment sector reforms; and second, a $1.5 billion multilateral investment fund administered by the Inter-American Development Bank to provide support and technical assistance to carry out investment reforms.

Finally, the initiative provides for official debt reduction for those countries which establish sound economic policies and liberalize their investment regimes to promote domestic and foreign investment. The administration is prepared to offer reductions of concessional AID and Public Law 480 debts of eligible countries and to sell a portion of nonconcessional Eximbank and CCC obligations of these countries to facilitate debt-for-equity or debt-for-nature swaps. Interest payments on the reduced concessional obligations will be accepted in local currency and dedicated to support environment programs in the debtor countries.

In addition, we have proposed that the IDB immediately join the IMF and the World Bank in making available enhancements to support debt and debt service reduction negotiated with commercial banks under the Brady plan. Although Mexico has already completed a comprehensive debt reduction package with its commercial bank creditors, other Latin American and Caribbean countries could use enhancements from the IDB, along with those received from the IMF and the World Bank, to secure new debt instruments or engage in buybacks agreed to as part of commercial bank financing packages.

CONCLUSION

In concluding, Mr. Vice Chairman, I would like to emphasize the importance of seizing this moment in our economic relations with Latin America. We have the opportunity to facilitate a permanent shift from decades of closed, state-controlled stagnation to open, market-oriented development and growth. With your support, the proposed FTA with Mexico and the Enterprise for the Americas initiative can meet this challenge with decisive action.

Thank you, Mr. Vice Chairman.

Senator SARBANES. Thank you very much, Mr. Mulford.

Mr. Wallace, please proceed.

STATEMENT OF ROGER WALLACE, DEPUTY UNDER SECRETARY FOR INTERNATIONAL TRADE, U.S. DEPARTMENT OF COMMERCE

Mr. WALLACE. Thank you, Mr. Vice Chairman, members of the committee.

I want to thank you for giving me the opportunity today to discuss the proposed United States-Mexico free trade agreement and the President's Enterprise for the Americas initiative.

In a major shift, nations throughout Latin America have begun implementing market-oriented economic reforms to join the global economy of the 1990's. They have recognized that in today's volatile and competitive international order, they are poorly served by the inward-looking economic policies of the past.

These changes have created exciting possibilities for improvement in United States-Latin American trade relations. Five years ago, a United States-Mexico free trade agreement would have been inconceivable for either country. Today, it makes excellent sense for both. I would like to first discuss the free trade agreement, and then the trade components of Enterprise for the Americas initiative.

UNITED STATES-MEXICO FREE TRADE AGREEMENT

Mexico is our third largest trading partner, and one of our fastest growing export markets. United States exports to Mexico have grown by 50 percent in the last 2 years, with bilateral trade reaching a record $52 billion in 1989. A free trade agreement with Mexico, coupled with our Canadian agreement, would position the United States in the middle of a North American economic unit with a combined output of $6 trillion, 25 percent more than the European Community's $4.8 trillion.

These are important numbers. While the eyes of much of the world have been on the unification of the European Community in 1992, the rising economies of the Far East, and the exciting developments in Eastern Europe, there have been some major and very promising developments closer to home as well.

Since Mexico joined the GATT in 1986, and especially under President Salinas, we have seen major changes in Mexican economic policies. Mexico has cut its top applied tariff to 20 percent, well below the 50 percent maximum that it agreed to when it joined the GATT. Import licenses, which covered all Mexican imports several years ago, now cover only about 230 items, or 7 percent of the value of United States exports to Mexico. In May of 1989, Mexico revamped its investment regulations to attract foreign investment, greatly improving access to Mexico for United States investors. Also, Mexico is making a major effort to improve its protection of intellectual property rights.

These changes have greatly benefited U.S. exporters, and the Department of Commerce has been active in promoting the opportunities they have created, particularly under the Joint Committee for Investment and Trade (JCIT). The JCIT was established by Secretary Mosbacher and his Mexican counterpart, Secretary Serra, in October 1989, and is designed to identify and promote trade and investment opportunities in each country.

Under the JCIT, several business development missions have already taken place, and more are scheduled for this fall. Also under the JCIT, Secretaries Mosbacher and Serra will conduct a series of conferences this fall in major United States cities on changes in Mexico's trade and investment mechanisms and their implications for U.S. firms.

Mexico is a market in which the United States has major historical and geographical advantages, and where we still have a very strong market share. We supply about 70 percent of Mexico's total imports and over 60 percent of Mexico's foreign investment. A free trade agreement would build on these advantages. It would contribute to long-term economic prosperity, stability, and growth in Mexico, increasing demand for United States goods. It would also reduce or eliminate barriers to U.S. goods and services.

The positive effect that a free trade agreement could have on the Mexican economy is important. The Latin America debt crisis of the 1980's, for example, may have cost the United States as much as $30 billion in lost exports to Mexico alone. Access to the United States market would provide Mexico with the hard currency it needs to service its debt and to purchase United States exports. By creating economic opportunities in Mexico, a free trade agreement could also have a positive impact on other important bilateral issues such as drugs, immigration, and pollution.

A free trade agreement should increase United States exports to Mexico, directly benefiting the United States economy. Exports are key to U.S. economic growth, and an export driven boost to the U.S. economy translates into increased jobs for U.S. workers. It is estimated that each $1 billion of exports generates about 22,000 U.S. jobs. Since some labor leaders have expressed concerns about the effect of a free trade agreement on U.S. employment, I would like to spend a moment on this point.

The free trade agreement will not contain any major provisions for the free movement of labor. The United States-Canada Free Trade Agreement, as an example, included only minor border crossing provisions to facilitate business travel.

Furthermore, while it is true that some U.S. companies may invest in Mexico to take advantage of lower wage rates, others will invest in the United States to take advantage of opportunities created by the free trade agreement and our highly productive, well-trained work force.

ENTERPRISE FOR THE AMERICAS

A free trade agreement with Mexico would be a natural first step toward the President's vision of an eventual hemispheric free trade zone. The vision has captured the imagination of the hemisphere's government and business leaders.

The President's statement of June 27 lays down some broad guidelines that can help us define our response to this challenge. First, the President's statement calls for a joint commitment to eliminate barriers to the free flow of trade in goods and services. This will require concessions from both sides.

Second, the President has stated a preference to work with individual countries or groups of countries that are reducing barriers to trade and investment. This will enable us to work for the broadest, most comprehensive agreements possible.

This approach should benefit from ongoing subregional economic integration in the hemisphere. We are already seeing subregional integration initiatives getting renewed attention since the President announced his initiative, and these should be encouraged as long as they raise no new barriers to U.S. exports.

The Central American countries are taking advantage of new regional stability to rebuild their common market institutions. The Caribbean Community, CARICOM, has announced plans to implement a common external tariff by January 1, 1991, and to work toward monetary union. President Bush is giving a new impetus to Andean solidarity by offering preferential treatment patterned on the CBI to Andean countries that are combating drugs. In the Southern Cone of South America, Brazil, Argentina, and Uruguay have set December 31, 1994, as a date to establish a subregional common market.

The Department of Commerce will play a key role in the trade and investment components of the Enterprise for the Americas initiative. In his role as Chairman of the Trade Promotion Coordinating Committee, the Secretary of Commerce will lead U.S. Government efforts to advance the business development objectives of the initiative and to stimulate private sector support for it.

Commerce's action program would include, for example: Leading high-level trade and investment missions to the region; undertaking special promotion programs to publicize the initiative and its attendant business opportunities; creating a "one stop shop" Latin American & Caribbean Business Development Center; coordinating private sector support of the initiative; and encouraging business-to-business linkages with the region.

It is important that this economic integration process, which President Bush has brought to the forefront of discussion, be consistent with our ultimate goal of global free trade. In this regard I would like to note that our commitment to multilateral trade policy, most currently represented by the Uruguay Round, remains our No. 1 trade opportunity. In the case of the United States-Mexico free trade agreement, Mexico's own commitment to multilaterialism—evidenced by its decision to join the GATT—is a key factor in our interest in negotiations.

We at the Department of Commerce look forward to working with Congress on the United States-Mexico free trade negotiations and on the Enterprise for the Americas. I would be pleased to respond to any questions that you may have.

Thank you, Mr. Vice Chairman.

Senator SARBANES. Thank you very much, Mr. Wallace.

We have been joined by Senator Graham, of Florida, who, while not a member of this committee, has had a very keen interest in the issue of U.S. economic policy toward Latin America, and in fact, sat in with the Joint Economic Committee in the spring when we held the hearing with the Council of the Americas, in which, interestingly enough they underscored a point in your statement, Mr. Wallace.

That point is the extent of the trade flows between the United States and Latin America. The Council of the Americas, in fact, argued that these flows dwarfed Eastern Europe and would continue to do so if you projected into the future. They were pleading for some attention to their problems which I'm happy to see the President has responded to with these initiatives that he has now offered.

Senator Graham, do you have any opening comments that you want to make?

OPENING STATEMENT OF SENATOR GRAHAM

Senator GRAHAM. Mr. Vice Chairman, I appreciate the opportunity to participate in this hearing which is on a subject of great interest to our nation and its political and economic future. I commend the President for the strong leadership which he has taken.

One of the things which is obvious from events of the past few months is that the clock by which we judge the time for action to occur is moving at an accelerated rate. It was almost 13 months ago that the vice chairman, other members of the Senate and myself were at the residence of the U.S. Ambassador to Poland. It was at a dinner that for the first time the subject of German reunification was seriously broached in my own experience.

And at that time the feeling was that it might be possible that the two Germanies could reunify by 1995. We now know that time schedule was significantly accelerated and it in fact will occur in less than a month.

I believe the same acceleration needs to be true in our hemispheric relations and the time for the achievement of the United States-Mexico free trade agreement and the American enterprise concept should be during this decade. I am very anxious to see that the Congress be a full and enthusiastic partner in accomplishing these objectives, and I appreciate the vice chairman having called this hearing to give us this opportunity to become more aware and more participatory.

Thank you.

Senator SARBANES. Very good.

We are very pleased to have you with us today.

At the outset, let me just ask a couple of questions for the record.

The President postponed his trip to Latin America that was to have taken place this month. When will the President be going, do we know?

Mr. MULFORD. The present thinking is that he may reschedule the trip for late November or early December. But as far as I know, a definitive decision on dates has not been set.

Senator SARBANES. Where was he to have gone under the previous plan, do you recall?

Mr. MULFORD. He was to have gone to Venezuela, Brazil, Uruguay, Argentina, and Chile.

Senator SARBANES. I assume they will remain the probable countries.

Mr. MULFORD. I believe so, yes.

Senator SARBANES. The administration has not yet asked for authority to negotiate the free trade agreement, have they?

Mr. MULFORD. Yes, the President transmitted the legislation to Congress on Friday.

Senator SARBANES. For the free trade agreement?

Mr. MULFORD. No, no, for the Enterprise for the Americas initiative.

Senator SARBANES. What about the authority to negotiate a free trade agreement with Mexico?

Mr. MULFORD. That has not been forwarded yet.

Senator SARBANES. Do you anticipate forwarding it shortly?

Mr. MULFORD. My understanding is it will be forwarded in the coming days.

Senator SARBANES. All right.

Mr. Wallace, you talk about this middle North American economic unit with a combined output of $6 trillion, 25 percent more than the European Community's $4.8 trillion.

How much of the $6 trillion is the United States'?

Mr. WALLACE. A very significant amount. Mexico's GNP I think is 4 percent of ours, and I'm not sure what the Canadian aspect of it is. But we would be combining with our first and third largest trading partners in terms of two-way trade.

We have, what, a $5 trillion GNP, is that what it is?

Mr. MULFORD. Approximately, close.

Mr. WALLACE. So 80 percent.

Senator SARBANES. Eighty percent is the United States, is that right?

Mr. MULFORD. Roughly.

Senator SARBANES. What percent of the $6 trillion is Canada's GNP and what percent is Mexico's?

Mr. WALLACE. Well, I think Mexico is 4 percent of our GNP and that would leave the additional 16 percent Canadian. Does that sound right to you?

Mr. MULFORD. I don't know.

Mr. WALLACE. A little lower.

Senator SARBANES. Do you know what the largest percent of the European Community's combined output any single country has? I assume that would be Germany.

Do you know what percent that is?

Mr. WALLACE. Thirty percent. After unification, Germany will account for close to 30 percent of the GNP for the European Community.

Senator SARBANES. I ask those questions because, as impressive as that statement sounds on first blush, it seems to me if you probe beneath it you get a little different impression.

I mean obviously this is an important economic unit, but it remains so large in the picture because the United States is so large in the picture. The European Community is a very different proposition when you put together a number of fairly significant economies, no single one of them that huge. I take it from what you have told me in fact the largest of the economies within that unit is 25 percent of the total.

In his speech on the hemisphere, President Bush indicated that he wanted to make our ultimate aim a free trade system that links all of the Americas: North, Central, and South. The President of Mexico responded to that aim by requesting the initiation of talks between the two countries on a bilateral free trade agreement.

Before we turn to Mexico, I would like to inquire whether any other countries have expressed an interest in opening bilateral free trade negotiations?

Mr. MULFORD. Well, at this point when the President made his speech, he indicated that our position was, first of all, that we would emphasize as a matter of priority the completion of the negotiation of Uruguay Round this year. And that was done in order to emphasize that Latin American countries in general have the most to be gained by a successful completion of that negotiation.

Then he said that we would be willing to negotiate free trade agreements afterward with groups of countries particularly that came together to reduce barriers between themselves and possibly in certain circumstances with other individual countries besides Mexico.

In the meantime, we are ready now and are negotiating bilateral framework agreements with countries. And some of those have been completed, others are under discussion. There is a great deal of interest on the part of Latin American countries who have already expressed an interest theoretically in FTA's with the United States.

One group is the Southern Cone of countries, Brazil, Argentina, and Uruguay. Chile has indicated an interest in trying to negotiate a free trade agreement with us individually. No decision has been made on that as yet. And in general there is a lot of interest in Latin America about pursuing FTA's down the road.

I saw an article in which Chile actually thought it might come in ahead of Mexico on a free trade agreement.

Senator SARBANES. Is there any substance to that?

Mr. MULFORD. Our position is that Mexico's negotiations will come first, and the completion of the Uruguay Round must take place before we engage in further free trade agreements. So we will need to be substantially down the road with Mexico before another FTA negotiation is undertaken.

Senator SARBANES. You assume a successful completion of the GATT negotiations as I read your statement, is that correct?

Mr. MULFORD. We are certainly hoping for a successful conclusion by the end of the year.

Senator SARBANES. Is all the rest of this dependent upon that?

Mr. MULFORD. Well, in the sense that the Latin American countries and the United States clearly have the most to gain by a successful completion of the Uruguay Round. And we are all assuming for the time being that a successful completion can be negotiated.

Senator SARBANES. From the response you have given, I take it that we should regard the forthcoming negotiations with Mexico as a precursor or precedent to similar negotiations with other countries in the hemisphere, rather than something that has a sort of a special case nature to it, given the proximity and existing close trading connections between the two countries?

Mr. MULFORD. Well, it has special features about it because of the proximity and the close relationships between the United States and the Mexican economies. And we have clearly committed ourselves to negotiating the FTA with Mexico first. But we have said that we must be well on our way in that negotiation. We have not committed ourselves at this point to completing the Mexican negotiation before we undertake any further negotiation. And I think that's an important point.

Senator SARBANES. How many negotiations would you expect to have going at one time?

Mr. MULFORD. I don't think I can answer that as well as Ambassador Katz could because the U.S. Trade Representative will be heavily in demand in that process. So I feel he should probably answer that——

Senator SARBANES. A number, though, as you envision this process?

Mr. MULFORD. Just as things stand now, I don't think I can answer that question effectively, Mr. Vice Chairman, without consultation with the U.S. Trade Representative.

Senator SARBANES. Mr. Wallace, recently the Commerce Department found that Mexican cement producers had been dumping cement in the United States markets, is that correct?

Mr. WALLACE. That is correct.

Senator SARBANES. Does that finding raise questions in your mind about the feasibility of a free trade agreement?

Mr. WALLACE. No, we found 58 percent margins in that case for most Mexican cement companies. As we go through negotiating the agreement, all of our antidumping/countervailing duty laws and everything else are going to be maintained. In effect, I think these laws are not going to have any significant bearing on the negotiation process itself.

Senator SARBANES. What mechanisms do you believe would be needed to protect the American producers against the dumping of products?

Mr. WALLACE. Well our antidumping/countervailing duty laws will remain intact. We have developed this dispute resolution procedure with Canada. And I don't know whether that will be part of the agreement with Mexico, but I imagine there will be some kind of dispute resolution procedures put into effect so that significant trade distortions can be addressed.

Senator SARBANES. Let me ask both of you, how deep is your concern as to whether you can have adequate safeguards for U.S. producers in the context of a free trade agreement?

Mr. MULFORD. I think, Mr. Vice Chairman, that we learned a good deal about these kinds of problems in the Canadian negotiation. I'm sure you remember that as we approached and even during the Canadian negotiation there were a number of areas of substantial disputation between the United States and Canada on specific issues or in specific industries.

And what we tried to do was take the view that a broad based free trade agreement that covered the multitude of relationships between the two countries was a higher priority than allowing ourselves to get stuck in a stance on a specific narrow issue that would stop the process from going forward.

In the end, most of the areas of dispute were adequately dealt with within the trade negotiation. And my guess would be that we will find a similar pattern with Mexico where within the broad rubric of the negotiation we will sort out those items of particular difficulty and exacerbation between us.

But, I think, to try to work out in advance or lay out the parameters in advance of how those things would be dealt with, might not lead to the engagement on a broad front that is necessary to a successful agreement.

Senator SARBANES. What would you expect the consequences of a free trade agreement for trade between the two countries to be? What areas would you expect to see the fastest growth in Mexican exports?

In what areas would you expect to see the fastest growth in United States exports to Mexico?

And what do you see as the cumulative impact of these trade shifts on the bilateral trade balance between the countries?

Ambassador Katz, we are pleased to have you. I think maybe we will suspend the question, and take your statement and then resume the questioning with the full panel.

Mr. KATZ. Thank you, Mr. Vice Chairman, I apologize.

Senator SARBANES. No apology is necessary. We understand that you had to fill in for Ambassador Hills.

Mr. KATZ. You have my prepared statement for the record. Perhaps I should summarize it.

Senator SARBANES. Please proceed as you wish.

STATEMENT OF HON. JULIUS L. KATZ (AMBASSADOR), DEPUTY U.S. TRADE REPRESENTATIVE

Mr. KATZ. I would state just very briefly that this hearing is timely. There are events in the hemisphere that are moving quite rapidly. The countries of Latin America are evolving their economic policies very rapidly in the direction of liberalization and democracy. Mexico is the best example of this. It has moved first and the farthest in terms of bringing down its trade barriers to very low levels for a country in its economic position. And this has provided both an example and an incentive to other countries in the region to do the same.

As you know, a decision has been made to enter into free trade negotiations with Mexico as soon as procedures and legal requirements have been met.

We anticipate the beginning of the negotiation with Mexico sometime in the late spring of next year. And we would hope to conclude negotiations before the end of 1991.

In the President's Enterprise for the Americas initiative, we have also held out the possibility of free trade arrangements with those countries. Our immediate objective, of course, is to the countries of the hemisphere. A number of the countries are enthusiastic supporters and very active in those negotiations. We also foresee the possibility of additional trade liberalization—indeed we are already entering into framework agreements with a number of countries in the area. We see those as an interim arrangement to advance our economic relations and our trade relations with them. We have such agreements with Colombia, Bolivia, and Ecuador, and we will be talking to Argentina, Brazil, Uruguay, and Paraguay as a group and with Chile. So things are moving very rapidly in the direction of evolving our trade relations.

Thank you, Mr. Vice Chairman.

[The prepared statement of Mr. Katz follows:]

PREPARED STATEMENT OF HON. JULIUS L. KATZ

Mr. Chairman, I am pleased to be here today to discuss "New Economic Policies Toward Latin America." This hearing is timely, not only because the United States is currently establishing a new economic relationship with Latin America, but because a new economic philosophy is taking hold in Latin America that makes it all possible.

For the first time in decades, if ever, virtually all Latin American countries have leaders committed to economic liberalization and democracy. They face daunting and distinctive economic and political problems at home, but their fundamental commitment to opening their economies and competing in world markets represents an extraordinary and historic opportunity.

The United States has long had a special political relationship with our neighbors in this hemisphere. The economic policy changes underway in the region hold the prospect that we can now forge a cooperative relationship in the economic sphere as well, to our mutual advantage. At USTR we are seeing the change vividly in our new trade policy relationships.

In the Uruguay Round trade negotiations we have seen a new commitment from individual Latin countries to the process and a willingness to participate meaningfully in the negotiations. Latin American countries such Argentina, Brazil and Colombia are among the leaders of the Cairns Group of agricultural exporting nations that has been so helpful to us in pushing for comprehensive agricultural trade reform. Venezuela and Ecuador have joined Mexico as recent new members of the GATT, taking on significant trade liberalization obligations in doing so.

These countries see the Round's success as vital to their own prospects for meaningful economic reform. And we are placing considerable emphasis in working with Latin American countries as the Round moves into the final, critical phase. Ambassador Hills travelled to the region in June and obtained an unusually strong statement of support from the OAS Ministerial and bilateral commitments of cooperation from key countries.

But Latin America has also reached out to the United States bilaterally. While there are important country-by-country variations, a prime leader in the economic reform process has been Mexico, our closest Latin neighbor and our third largest trading partner.

Mexican Reforms

For many years we did not see eye-to-eye with Mexico on trade policy. In our view, Mexico's policies were overly interventionist, with significant restrictions on trade and investment, a large degree of state ownership and control of business, and a highly regulated business climate.

The first signs of change appeared under former President de la Madrid, who, in 1986, took the major step of having Mexico join the General Agreement on Tariffs and Trade (GATT).

But it is after President Salinas took office in 1988 that the pace of change accelerated and intensified. The Salinas Administration has moved a highly restricted trade and investment regime and toward becoming one of the most open among developing countries. I would like offer some examples of the changes.

- In 1983, all Mexican imports required an import license. Today, only 230 items, or about seven percent of the value of U.S. exports, need import licenses.

- Mexican tariffs have been cut from peaks of 100 percent in the mid-1980s to a top applied tariff of 20 percent. Mexico's trade-weighted tariff has fallen from over 25 percent to about 10 percent today.

- o Last year, new investment regulations were issued, making Mexico more open to investment by U.S. and other foreign investors.

- o Mexico has pledged to strengthen its protection of intellectual property rights, including lengthening the patent term to 20 years, extending coverage to such areas as pharmaceuticals and chemicals, and improving protection for trademarks and trade secrets. As a result, in January, Mexico was removed from the U.S. special 301 "priority watch list".

- o Government's role as an owner/operator of business is being cut back. Of 1155 state-owned enterprises in 1982, 801 have been authorized for divestment and 619 have actually been privatized. Sectors affected include banking, airlines and telecommunications.

U.S. Policy Toward Mexico

These reforms have helped achieve their intended result -- a turn-around in Mexico's economic performance. Since we have a direct interest in the health and vitality of Mexico's economy, we have encouraged and supported the evolution of Mexican policy toward deregulation, privatization and more open markets.

- In 1987, we concluded the "Framework of Principles and Procedures for Consultation Regarding Trade and Investment Relations". This agreement established a consultative mechanism to discuss trade issues and resolve trade differences. Under its auspices, 10 joint working groups in five areas have been established: agriculture, services, investment and intellectual property rights, tariffs, and industry.

- In October 1989, Presidents Bush and Salinas signed the "Understanding...Regarding Trade and Investment Facilitation Talks" (TIFTs). The TIFTs process builds on the 1987 Framework Agreement, establishing a mechanism for negotiations on specific issues or sectors. This March, we agreed that "petrochemicals" and "standards, testing and certification" would be the first areas for negotiation under TIFTs. The first "standards" negotiation was held in July.

- A year ago, we renewed and liberalized the steel VRA and reached a bilateral consensus agreement under which subsidies and nontariff trade barriers to steel would be prohibited. We are working to extend those disciplines multilaterally.

- In February, we signed a textile and apparel trade agreement which reflects the near balance in textile trade between the two countries. It eliminated quotas on over half of Mexican-made textiles, boosted most of its other quotas by a quarter and expanded the scope of mutually beneficial outward processing trade.

- In April, Mexico received $2 billion in benefits under the annual review of the Generalized System of Preferences (GSP) program. Mexico was the major beneficiary from the review; our decision took into account the impressive changes in Mexico's policies.

- In 1989, the United States and Mexico reached a new debt accord under the Brady Plan. That agreement, which covers over half of Mexico's total external debt, provides substantial debt and debt service relief. The accord has bolstered investor confidence in Mexico and helps place Mexico on a firm footing for future growth.

Outstanding Issues

While we have come far in our trade and investment relationship, that does not mean all outstanding issues are resolved, or that new ones will not arise. In any trade relationship, particularly one totaling over $52 billion annually, some disputes are bound to occur. But it is a measure of our progress that we have established the means to expand trade and resolve our differences in an atmosphere of friendship and respect.

- We would like to see Mexico take additional steps to eliminate or reduce tariff and nontariff trade barriers. In agriculture, for example, import licenses still restrict substantial U.S. exports to Mexico, including such commodities as grains, dairy products and certain fruits and vegetables. Licenses are also required on wood and wood products and on some auto parts. Licenses are sometimes granted or withheld in an arbitrary manner and, in some cases, act as import bans. We are working vigorously to see that unjustified licensing requirements are eliminated as required when Mexico joined the GATT.

- More could be done to liberalize investment in Mexico. While Mexico has administratively eased its investment regulations in important respects, we believe Mexico should continue to ease obstacles and should amend its national investment law. Ownership of key industries, such as petroleum and financial services, remains reserved by the Constitution specifically or by statute to the State or Mexican nationals, or foreign investors are limited to a minority interest. Real estate investment is restricted in some areas.

- In services, we seek additional openings in many areas, including banking, securities, insurance and transportation. In these areas in particular, market entry is restricted, and in some sectors U.S. firms are totally denied access to the Mexican market.

- While Mexico has announced it will improve its patent and copyright laws, those pledges need to produce concrete results. Mexico must provide effective protection and enforcement of intellectual property rights, with reforms offering immediate commercial benefits to intellectual property rights holders.

The FTA and the Future of U.S-Mexican Trade Relations

Today, the United States and Mexico stand ready to begin their most ambitious cooperative trade effort yet: the negotiation of a comprehensive bilateral free trade agreement.

In June, Presidents Bush and Salinas strongly endorsed the goal of a comprehensive free trade agreement between our countries. They directed the Mexican Commerce Secretary, Dr. Serra, and Ambassador Hills to begin the preparatory work and consultations needed to start negotiations on an FTA and to report back to them as soon as practicable.

Since then, the Administration has held a series of consultations with Members of Congress and private sector groups, seeking advice on the idea of an FTA with Mexico. While there are some concerns, there has been a good deal of interest in and support for this accord.

Based on this work, Dr. Serra and Ambassador Hills have jointly recommended to the Presidents that the United States and Mexico formally initiate negotiations on a comprehensive bilateral FTA. They agreed that an FTA should lead to the progressive elimination of impediments to trade in goods and services and to investment, as well as to the protection of intellectual property rights establishment and the establishment of fair and expeditious dispute settlement mechanisms.

Presidents Bush and Salinas have taken up this recommendation, and President Salinas has proposed that Mexico and the United States now initiate formal negotiations. President Bush intends shortly to notify Congress of his intent to negotiate an FTA with Mexico.

This notification is the first step in the process toward negotiating an FTA under U.S. "fast-track" laws and procedures.

Under our trade laws, the House Ways and Means and the Senate Finance Committees will be considering the President's notification over the coming months. Unless either Committee disapproves negotiations, we will begin formal intensive negotiations in Spring 1991 under the fast-track procedures.

Throughout this process, we will continue our consultations with the Congress. In any potential agreement, we want a partnership with Congress and will listen closely to its advice. We will also seek the views of our private sector advisors and others with an interest in an FTA and seek to address these concerns to the extent feasible.

Enterprise for the Americas

Another major development in U.S. trade policy towards the hemisphere, building on the U.S.-Mexico free trade process is the President's "Enterprise for the Americas Initiative." The President announced this comprehensive and important new policy departure in a major address June 27.

What sets the Enterprise for the Americas apart is that it is not simply a trade policy initiative. The EAI is a more comprehensive economic initiative, and an initiative that will go far to cement a new political relationship between the United States and its neighbors in the Hemisphere. Trade is just one part of this strategy, with our overall objective being the attainment of higher sustained rates of economic growth.

Another remarkable aspect of the Enterprise Initiative has been the reaction to it in the Hemisphere. Not since the Alliance for Progress has an American initiative been greeted with such enthusiasm and excitement, and perhaps the response to the Enterprise Initiative is all the more significant since it is a call on all of the nations of the Hemisphere to take medium-term political risks to benefit our long-term economic future.

The President's speech was thematic and visionary. He laid out our objectives, explaining how trade liberalization, investment policy reform and debt reduction could work in concert to remove the obstacles to hemispheric economic growth and development.

In his speech, the President described three trade components of his initiative:

o One, he called on the countries of the region to work with us to secure a successful outcome to the Uruguay Round of trade negotiations, promising deeper tariff reductions on items of interest to countries of the region;

- Two, he set out the long-term goal of a free trade zone stretching from Alaska to Tierra del Fuego and announced a willingness to enter into free trade agreements with other markets in the region, particularly with groups of countries associated for the purposes of trade liberalization;

- Three, he proposed that interested countries negotiate "framework agreements" with the U.S. to begin the trade liberalization process.

Implementation of the Initiative is well underway. We are preparing tariff offers for presentation to the latin countries in the context of the Uruguay Round. We have recently signed "framework" agreements with Colombia and Ecuador and are discussing similar agreements with several other countries, including Venezuela, Costa Rica and Chile. We also are discussing a framework agreement with Argentina, Brazil, Uruguay and Paraguay as a group.

As with Mexico, the framework agreements will be the vehicle for addressing specific trade and investment policy concerns, as well as laying the ground for movement toward free trade arrangements leading toward a hemispheric zone of free trade.

There have been comments suggesting that our vision of a hemispheric free trade zone somehow represents a decision by the U.S. that the GATT Round is doomed to failure and that we had better get to work to create our own trading bloc.

Nothing could be further from the truth. Our trade policy toward Latin America is consistent with and supportive of our overall trade policy, which is built on an unshakable commitment to the multilateral trading system. We have been and will continue to be a leader in the development of the GATT and the strengthening of its disciplines.

We also will take such bilateral opportunities for trade liberalization as they arise: we have done so in concluding the historic U.S.-Canada free trade agreement and the earlier U.S.-Israel FTA. We believe we now have a similar opportunity to make a breakthrough in the reduction of trade barriers with Mexico, our other immediate neighbor. We hope we can also take advantage of the historic opportunity to reduce trade barriers throughout the Hemisphere and over the longer term make President Bush's goal of a free trade area from pole to pole a reality.

While we are second to none in our commitment to trade liberalization, we are firmly committed to use our strength to open markets and to oppose unfair trading practices that distort the marketplace for all.

We are at the start of what should prove to be a period of historic significance. We have much hard work ahead of us. But with clear goals and determination, we should be able to find creative new ways to expand trade and economic opportunities on both sides of the U.S.-Mexican border and throughout the Hemisphere.

Senator SARBANES. Let me then repeat the question that I just put.

In what areas would you expect to see the fastest growth in Mexican exports?

In what areas would you expect to see the fastest growth in United States exports to Mexico?

And what did you see as the cumulative impact of these trade shifts on the bilateral trade balance?

Mr. KATZ. Our initial analysis indicates that the expansion of trade with Mexico would be really across the board. Manufacturers have grown very rapidly in trade in both directions. A great deal of Mexican exports come out of the Maquiladora plants or the assembly operations, but increasingly manufacturing is growing beyond those trade zones. So we would see increases in the automotive sectors, in chemical, and petrochemicals.

We would see expansion of trade in agriculture in both directions with temperate agricultural products going into Mexico and horticultural products coming into the United States.

In terms of the trade balance of the long term, it is really hard to predict that because that will depend upon factors other than just trade and investment. It will depend on macroeconomic policies, interest rates, and the effect of that on the exchange rates. But we would expect a fairly balanced trade at least for the initial years of the agreement.

Senator SARBANES. I would like to ask, are you familiar with an article in the Washington Post on August 1 by Robert Dunn a professor of economics at George Washington University?

Mr. KATZ. I believe so, Mr. Vice Chairman.

Senator SARBANES. Are you familiar with it, Mr. Mulford?

Mr. MULFORD. No, I'm not.

Senator SARBANES. Well, low paid workers would lose even more in a free trade pact with Mexico. Let me just quote from it for a moment:

> Although free trade between the United States and Mexico would increase total incomes in this country, it would also redistribute income away from unskilled and semiskilled labor and toward professional and technical labor and capital. Because the "winners" would be people whose incomes are already above average while the "losers" would start with below average incomes, this arrangement could make the distribution of U.S. incomes more unequal.

It then goes on to cite two Swedish economists who note that where there is free trade between the countries when one has an abundance of labor, and the other an abundance of capital, each will export products that use a great deal of its abundant input, and notes that in the United States-Mexico case this means that the United States will import labor intensive goods such as garmets and shoes from Mexico and will export capital and professional and technical labor intensive goods, such as computers and machinery.

Dunn then talks about the impact of that upon unskilled and semiskilled labor in this country. He makes the point that the overall expansion would be beneficial, but that its distribution would be such that you would have this very marked uneven impact within the society. What's your response to this point?

Mr. KATZ. I did not agree with the points made in the article.

For one thing this agreement clearly—or such an agreement, I should say, would have a much greater impact on Mexico than it would on the United States because of the disparity in the size of the economies. But clearly lower wage rates and labor is a great deal of what is Mexico's comparative advantage right now. But that could change very quickly.

Wages in Mexico would rise very rapidly in the face of free trade. We have seen some examples already. What has happened is that Mexico brought down its barriers, and it has done so in rather dramatic fashion in about 5 years. In 1986 when they joined the GATT, they had duties in excess of 100 percent with quotas on virtually everything. When they joined the GATT, they bound their tariffs at 50 percent and they brought them down on the average around 10 percent, 9 or 10 percent, with no rate higher than 20 percent. And what has happened is that we have a surplus with them on textile and apparel trade. So the trade does move in two directions. We import automotive parts from Mexico——

Senator SARBANES. Their sending of textiles into this country is not unlimited, is it?

Mr. KATZ. It is not unlimited, no, sir.

Senator SARBANES. Why would we have that trade balance if it were unlimited?

Mr. KATZ. I'm not sure, but I think we might do very well, because they do not have restraints on their exports to other countries. And similarly they import textiles and apparels from everywhere in the world.

Senator SARBANES. Then it is the view of the Trade Representative's office that you need not make any special transitional arrangements or address the problem of the impact of a free trade agreement with Mexico on working people in this country?

Mr. KATZ. No, sir.

Senator SARBANES. The normal operations of the trading rules will take care of that problem—or is there a problem whose dimensions are such that you need to address it in terms of working out special arrangements?

Mr. KATZ. Mr. Vice Chairman, it is not our view that we don't need transitional arrangements; we do need transitional arrangements. In fact, we would expect that, at a minimum, the provisions of the agreement will phase in a period of at least 10 years. Although we haven't—that was what we did in the case of Canada.

We haven't yet come to any conclusion exactly what the terms would be with Mexico. Moreover, we have not merely completed the kind of sectoral analysis that we need to do. And that is underway now.

We expect to use the period between now and the initiation of negotiations—which as I have said, is likely to be sometime in the late spring—to use that period for study of and consultations with affected sectors in the United States. In fact we have already been in contact with various industry groups to determine what kind of problems that would be involved.

Now, I think on the basis of past experience we have some ideas, but we are not willing to merely trust our instincts. We intend to look at this very carefully.

Senator SARBANES. I have a couple of more questions in this area, and then I'll defer to Senator Graham.

Promoting closer economic integration between the economies at very different levels of development is a difficult proposition at best.

What problems do you anticipate will arise in the differences in wage rates and regulatory regimes if we were to conclude a free trade agreement with Mexico or, indeed, any developing country in the region?

Mr. KATZ. Well, as I have indicated Mr. Vice Chairman, we want to examine this very carefully, but differences in wage rates are reflected in differences in exchange rates and other economic policies. So I don't think it should be assumed that merely because there are differences in wage rates that the removal of tariffs and other trade barriers would bring about gross changes.

What it will do is to permit greater efficiency, but in many cases our tariffs are very low now, particularly in manufactured goods. We have tariffs that on the average are about 4 percent. The effects, I think, are likely to be greater in the other country and that is something we will want to look at as well.

Senator SARBANES. Well, let me ask you this question.

In the European Community there is about a 5 to 1 ratio of GNP per capita between Germany, the richest country, and Portugal, the poorest.

Now between the United States and Mexico, the income gap is more than 11 to 1. The European Community has a whole scheme for addressing these gaps within the Community which involve some significant shifts of resources from the high per capita income countries to the low per capita income countries.

Now, is that going to have to be part of this arrangement as well?

Mr. KATZ. I don't believe so. I don't believe we contemplate that. I think in Europe—for one thing you have economies which are much more regulated where there is a much greater use of government funds in terms of support of and subsidy of investment and industry. And we would not be contemplating that here.

I don't personally believe that is going to be necessary. I think, given the opportunities, investment will flow, but those are questions that we will be addressing in our prenegotiation studies and consultations and undoubtedly that will arise in the negotiations.

Senator SARBANES. I am struck by a sort of attitude that seems to equate this to the United States-Canadian free trade agreement in terms of what's faced and how it is to be dealt with. My perception is that it is not the same given the differences in the levels of development and given the differences in the trade arrangements and the trade flows. That this is a very different sort of situation, and really has to be perceived as having some problem that has to be overcome.

Mr. MULFORD. I think, Mr. Vice Chairman, you have hit a very important point. And I think we do have to be very concerned and rather sober in our assessment of these kinds of problems.

You mentioned Europe. We are not seeking here to reproduce the EC single market concept which involves these rather elaborate mechanisms that you have mentioned which are also found within European countries. And, for example, the German constitution between Federal revenues and State or Provincial revenues and revenue sharing and so forth.

But it seems to me that we are looking at here is an attempt to improve and expand our trade and investment relations with countries in Latin America that have really made the commitment to basic policy reform. That is a necessary part of reforming their economy to the point where we can indeed strike this kind of agreement.

You have made the point that Canada and the United States are much more similar in terms of developmental stage income levels, et cetera, than the United States and Mexico or other countries in Latin America. And that is perfectly true.

I think what it means is that there is a lot of research to be done. There are a lot of assessments to be made as we approach these negotiations. And we will have to be, I think, creative and attempt to evaluate these differences and see how they affect not only the negotiation but also the final product.

But, I think, what's important is that within quite a short period of time Mexico has changed substantially its general policy stance in terms of macroeconomic policy, exchange rate policy, its view to the rest of the world: it has joined GATT, it has liberalized its trade regime. It has not substantially liberalized its investment regime, except that it is administering its regime more liberally. But its fundamental investment regime remains in place.

But what's important is that President Salinas has made major changes. And it looks as if Mexico is going to stay that course. And that is a continuing and dynamic situation of great importance to us which, in my opinion, will allow us over time to negotiate some sort of free trade agreement which is a great deal better than having none. And with regard to other countries in Latin America, it will be necessary for those countries to go on implementing major market reforms and liberalizing their regimes before they can really engage in a successful negotiation with us, except a couple of places, which today—such as Chile—are very much bright spots. But we are looking at a dynamic process that will take time. And I think you have raised questions which would benefit our mutual consultation between the administration and Congress.

Senator SARBANES. Senator Graham.

Senator GRAHAM. Thank you very much, Mr. Vice Chairman. I would like to follow on with some of the questions that you have been asking.

The President's announcement last summer of this new U.S. interest in Latin America provoked the President of Mexico to request the commencement of negotiations with his country. Have there been any analogous responses, specific requests to initiate a free trade agreement negotiation with other countries?

Mr. KATZ. Not with the same degree of formality. That is there is a formal—there have been expressions of interest from other countries, but in the case of Mexico, there is a formal request from President Salinas.

Senator GRAHAM. Mexico is the only country that has made such a formal question to commence negotiations?

Mr. KATZ. Yes, sir.

Senator GRAHAM. There has been concern among some of the countries of the Caribbean and Central America as to what the impact would be on their economic development, and particularly some of the initiatives which have been fostered through the CBI if there were a United States-Mexico free trade agreement?

What is our assessment of the effect of a United States-Mexico free trade agreement on the CBI countries?

Mr. KATZ. Well the CBI countries, of course, now have to a large extent—they have one-way free trade by reason of CBI. They do receive preferential access to our market. Mexico receives preferences on a great many items—not to the same extent as the CBI and certainly not in the area of many of the manufactured products. But clearly a free trade agreement between two countries does represent a discrimination between other countries. In the case of CBI it wouldn't be a discrimination, it would bring Mexico to the same level in many cases so that it will have some trade diversion effects.

That was one of our concerns at the outset when we looked at this, and our analysis revealed that this would not be a serious problem or a reason not to go ahead.

We are aware of the problem of trade diversion.

Senator GRAHAM. What would be the reaction of the administration if there were to be a series of requests for free trade negotiations on a parallel track with Mexico from countries in the CBI, either through their individual countries or through the subregional groupings such as in Central America and CARICOM that have now emerged?

Mr. KATZ. Senator, as you know, in the President's speech on this initiative, he indicated that we look toward a long-term goal of a free trade area in the entire hemisphere. And we would want to proceed in a way in which didn't result in fracturing the hemisphere, but promoted this trend toward ever-increasing reduction of trade barriers and the attainment of general free trade agreements. But we see that as being something that would take place over time.

Senator SARBANES. Ambassador Katz, I'm not clear from that response what your answer was to Senator Graham's question.

Mr. KATZ. We have——

Senator SARBANES. As I understood his question—it was what would your reaction be to a request to be put on parallel tracks with a Mexican free trade negotiation, I take it, as opposed to a sequential track.

Mr. KATZ. I don't think—I don't have in mind that countries would have to stand in line and each wait for the current negotiation to be completed. We would not have in mind doing a great many negotiations at the same time. It would really depend upon the circumstances and what the opportunities are and what the case is for a particular negotiation.

Such negotiations would be conducted under our own domestic legislative authority. And that as we have seen in the case of Mexico is a somewhat lengthy procedure.

We anticipate having the President notify the Congress shortly with respect to the Mexican request and that is required to lie before the Ways and Means and Finance Committees for 60 legislative days. And we calculate that will take us into next spring.

We haven't begun anything like that—a kind of intensive consultation process with the Congress or with the other countries. So we don't see ourselves being widely besieged by multiple requests. We think in fact if they came they would be better done on a regional or subregional basis.

So I think our ultimate goal is very clear. How we get from here to there, we will just have to see over time.

Senator GRAHAM. I would like to give some specificity to the ultimate goal: What do you see the end gain of this initiative for the Americas? Where do you see us being in the year 2000 as a result of this initiative?

Mr. KATZ. I find it rather difficult to forecast where we will be at any given point in time, but I would see an increasing trend in the direction of free trade.

I think what we have found is that such arrangements are, if you like, contagious. When you do one, there is an incentive to do others. The trade diversion effects that I have noted would create incentives for other people to try to get on board.

This process has just gotten underway. It may accumulate speed very rapidly. I think it's sensible and reasonable that we look toward that goal. How far we will be by the year 2000, I don't know. We might have concluded a hemispheric world trade agreement by then—that is quite conceivable. It might take place much sooner than that. This process may gather steam.

I think what we have found is that the idea has attracted great interest and support in the hemisphere. There is a great deal of interest in it.

Senator GRAHAM. My sense is that there needs to be some control; someone who understands both the radar, where we are trying to go, and the rudder that will be necessary to get there. That's a hemispheric and a domestic necessity.

There are some mixed signals now as we are, for instance, proposing a CBI type of relationship with Andean countries. We just passed CBI II. There is already now discussion of a CBI III, and, on top of that this new initiative and a free trade agreement.

Are those seen as having some sequential relationship with each other or are they all part of an evolving controlled process that will get us to a hemispheric free trade agreement?

If so, I think laying out that with somewhat greater specificity would give comfort to our neighbors in the hemisphere, and would begin to develop a domestic base of political support for what it is we have to do in order to get to that end objective.

Mr. KATZ. I think the strategy is very clearly laid out, Senator, in the President's speech. I think he attempted to address that. Now, there are events that occur that we need to take into account.

The Andean proposal is intended to meet a very specific and serious problem related to the interdiction of drug supply. But it is not inconsistent with the initiative; it moves in the same direction. Just as the CBI moves—and CBI II moved in that direction.

Mr. MULFORD. If I could comment on that, Senator.

In August, I had the opportunity to visit some of the larger Latin American countries, specifically to discuss their negotiations with banks, but also this issue of Enterprise for the Americas initiative came up.

What I found was, first of all, a very substantial enthusiasm on their part about the President's proposal: the visionary nature of the proposal; the fact that the President had combined for the first time the three issues of paramount importance to Latin American people in the economic area; namely, trade, investment, and debt. They see that as interlinked, and you have to find a solution to all of those to sort of make a Latin American recovery possible.

What I also found there on the trade front was a sort of reassessment going on in their own thinking. I think they, themselves, are thinking about how they should go about meeting this challenge.

In the southern part of South America the Argentineans, Uruguayans, and Brazilians clearly seem to have come to the conclusion that they should join together, form a free trade area, reduce barriers among them and then at some point negotiate a free trade arrangement with the United States.

I think we will find that other countries, the Andean countries, and Venezuela, for example, seem to be thinking about strengthening its trade relations with Chile, for example. And they have some discussions going on about themselves forming some sort of a trade arrangement.

Chile is in a sort of position where, on the one hand, it appears to want a free trade agreement with the United States as a matter of priority, and yet its neighbors wish Chile would join their group in the Southern Cone.

So I think we are going to see a period of thinking and reassessment. And the important point I think from our standpoint that we should be open and positive to this process, and we should let it develop and find out what Latin American countries seem to be wanting, in what directions they plan to move, and to try to tailor our response with the President's broad objectives to those needs.

It's important, it seems to me, that we treat this thing as a matter of the highest priority. In due course, I think we will probably need a better definition of the direction and specific steps that we must take. But I think it might be a bit premature to have that in order at the moment.

Mr. KATZ. Senator, if I could add another point to that.

It is not our objective over the long term to have a string of two-way arrangements between the United States and a whole lot of countries in Latin America; what we want is an integration in the hemisphere as a whole. So we are as interested in having the reduction of trade barriers between the countries in the region as we are between ourselves and them. And I think that's a very important part of our overall strategy.

Senator GRAHAM. Thank you, Mr. Vice Chairman.

Senator SARBANES. Well, let me just follow on.

The more broadly you define your objectives internationally, it seems to me, the more you have to pay attention to the domestic consequences of those developments, and the more you have to consider how to address whatever dislocations there would be domestically.

The CBI, even with all that had going for it, was controversial domestically. The testimony this morning in effect has not taken the path of arguing the Mexican arrangement as something special and unique as our other neighbor, Canada, but in effect has put it the first among equals so to speak, or the beginning hurdle as you address the balance of the hemisphere.

So you in effect, I take it, are going to be putting to the Congress, when it finally comes to an agreement, not only for Mexico, but an agreement as the precursor or the precedent for comparable actions elsewhere in the hemisphere. And it seems to me if that's the case that a considerable degree of thought has to be given to the domestic ramifications of these agreements.

Particularly, if, in the instance of the Mexican agreement, you have, in effect, disposed of or abandoned the argument that might have been made that this is just country specific and that it relates to all of the other factors we have in Mexico, including the immigration problem, the drug problem, other border problems, and so forth.

My sense is that this sort of broad objective which you have set out, which may make eminent good sense in the international context of dealing with the hemisphere, will complicate your domestic dealings.

Mr. KATZ. That's a fair statement, Mr. Vice Chairman. I think it is incumbent upon us to make that case. Inevitably each one of these situations has its own peculiarities and specialties.

Canada, as you say, was presented as being a unique situation and indeed it was because of the extent of the integration of the two economies that already existed before the agreement.

Mexico is another somewhat special case because it is contiguous to the United States. It is our third largest trading partner. We are their first largest trading partner by far; 70 percent of their trade is with us. But we are looking beyond Mexico, and we are looking ultimately toward a hemisphere-wide free trade zone.

Now, of course, I would also make the point that one of the strong motivations we have for this is that free trade is not an end in itself, it's an instrument of economic growth and progress. And it is important to our economy just as it is to the economies of the partner countries. Latin America is an extremely important market for the United States, and we have a vital interest in the health of those economies for that reason. And that is apart from all the other objectives we have, political, drug control, and everything else. So it's just on pure trade grounds alone, we would see considerable net advantages to us over the long term.

Senator SARBANES. Mr. Wallace.

Mr. WALLACE. Just let me echo that the International Trade Administration's primary function in government is to help U.S. corporations export goods abroad, goods that are made by American workers here. The economic problems that beset this hemisphere south of the border over the eighties, it has been estimated, cost U.S. exporters about $80 billion. That is a lot of products that can be made by U.S. business.

Our view is that the bottom line of the Enterprise for the Americas initiative is creating hemispheric prosperity, priming the pumps of economic growth as you pointed out, creating an environment for rapid economic growth. This will have a very positive effect on the American economy as demand increases for U.S.

goods and services needed to fuel this hemisphere prosperity. We already have—as Ambassador Katz said—we have a leg up in this hemisphere, we have long-term business relationships already set. And I think we, more than any other country, are in a position to take rapid advantage of increased economic prosperity in the hemisphere.

You can look at what's happened in European growth over the last few years. Our trade deficit, I think has gone a negative of $23 billion to a positive of about $1 billion. So I think in the long run—although while as Under Secretary Mulford said, it's hard to figure out exactly the tradeoffs on a sectoral basis right now—it's difficult to make the case that a prosperous growing Western Hemisphere is not going to have a very positive impact to the U.S. economy and to the U.S. worker as a whole.

Senator GRAHAM. I could not agree more with what you have just said. My concern is that if we were having this hearing just a few years ago, 5 years ago, we would have acquired quite a different statement. The whole concept of the Baker plan was focused on a very narrow relationship between U.S. commercial banks and Latin America as if nobody else had any interest in the economic growth of Latin America other than the banks getting their debts repaid. And we paid an enormous price for that, both in terms of loss of jobs through export and in terms of loss of credibility throughout Latin America.

I go back to that piece of history to underscore the fact that all of us who have an interest in achieving the objectives of the President are not commencing this initiative from a blank slate. We have a lot of work to do within this country in terms of building a domestic understanding of the importance of Latin American economic growth and political stability on important issues for this country. And we have an equally challenging job in Latin America to convince its leadership that we are serious about this, and that we are not going, 5 years from now, to have another plan. And the final complexity is that we are not dealing with this in a vacuum.

An article from the Financial Times, of September 2, entitled "Latin America Starts To Win Over Foreigners," talks about the fact that the Europeans and the Japanese are discovering Latin America. And we are not going to be the only trade missions down there or the only countries that will have an interest in trying to establish an economic relationship that will be mutually advantageous.

So that comment is that we need to have in my judgment a clear repetitive message as to what our goals are, what our commitments are, and then our actions need to be consistent with our rhetoric. And we are going to be under close scrutiny domestically and within the hemisphere as to our credibility in this initiative.

Senator SARBANES. I agree with Senator Graham.

Actually, the questions I'm raising are designed to try to sharpen your sensitivities to domestic considerations so that you don't encounter difficulties and obstacles as you move this process along.

Let me ask you another question along that line: Some of us observers have expressed concern that a hemispheric free trade area would have the effect of encouraging businesses to shift investments within the region to those countries where environmental controls were less rigorous. Do you believe this is a significant concern, and have you done any thinking about how to deal with this possibility? Let me cite to you an article in the Los Angeles Times in May of this year; the headline, "A Warmer Climate for Furniture Makers."

"Mexico: Fleeing antismog laws, some Los Angeles manufacturers flocked south, where environmental laws are less restrictive."

How much thinking has been done about this problem, and how is this one going to be addressed?

Mr. KATZ. We are doing quiet a lot of thinking about that, Mr. Vice Chairman, because we are confronting it in a number of ways. But it is not purely a matter of industries fleeing the United States. I think there is an increasing awareness throughout the world about the environment and the need to take measures to deal with it. And what we find are different kinds of problems that arise.

In some cases environmental standards may be more lax; in other cases they are more severe. So that we are finding trade barriers on the account of what might be referred to as green proposals. In the area of health and sanitary regulations, for example, this arises. I think in the long term—maybe not so long term, in the near term, the international trading community is going to have to address it on a broad basis. There are some initial approaches to that.

In the Uruguay Round negotiations, for example, there is a proposal to deal with sanitary measures through an agreement which would assure that measures are based on scientific need and not on desire to protect against imports. So there are two sides to this question and we are looking at it very seriously right now.

Mr. MULFORD. Mr. Vice Chairman, in the President's initiative there is a very important proposal which involves the creation of environmental trust funds for countries that engage in debt reduction negotiations on official bilateral debt with the United States. And as you recall, under the arrangements where debt is restructured on the concessional side, we would be willing to take interest payments in local currency which in turn would be put into those environmental trust funds. The guidelines for those trust funds are something that have to be negotiated between the United States and the country.

Of course, the presumption is that a country that engages in reducing its debt—its official bilateral debt with the United States—is also agreeing in principle to encourage environmental programs and the setting up of a trust fund arrangement that would utilize local currencies for it. I would imagine within that process we would address issues of the type that you have raised.

Senator SARBANES. How much is the Enterprise for the Americas initiative going to cost?

Mr. MULFORD. We don't—we don't know the full amount of the debt that will be treated under the initiative. But at the time that the proposal was put together it was designed to be budget neutral so that in budget terms there was not going to be a cost.

Senator SARBANES. I thought there was at a minimum a cost associated with the fund that the IDB—is that not correct?

Mr. MULFORD. That's correct. There is envisioned a multilateral investment support fund that would be set up in the IDB and would have funding over 5 years of over $1.5 billion, or $300 million a year, with $100 million of that amount per year coming from the United States and we would look to the EC and Japan to provide like amounts.

Senator SARBANES. Now, has that all been discussed with the IDB?

Mr. MULFORD. Yes, it has.

Senator SARBANES. I see.

Then in addition to that $100 million, are there any other costs—direct budget costs, associated with the President's initiative?

Mr. MULFORD. An answer to that, Mr. Vice Chairman, is a little bit harder to give at this point because of present budget negotiations. There are discussions going on about credit reform within the budget. And it's not impossible that the outcome of that discussion may involve some costs being incurred in the debt reduction area. That's something that is under discussion now. But in the original proposal it was a budget neutral concept where expected revenues from the countries to the United States would not be reduced.

Senator SARBANES. How much debt reduction would be involved? This is going to be official debt reduction, is that correct?

Mr. MULFORD. Yes.

There is a total of $12 billion of official debt from the United States to Latin America, Central America, and the Caribbean. Of that amount $5 billion is nonconcessional debt, that is to say Exim and CCC. And the balance of $7 billion is concessional AID and Public Law 480 debt.

On the concessional loans, we anticipate that the debt reduction agreed with the countries once they have met the qualifications will be very substantial. We have not quantified that in every repect. It will be negotiated on a case-by-case basis. But the reduction will be substantial—and by substantial, Mr. Vice Chairman, I believe the President referred to a figure of at least 50 percent.

In the case of nonconcessional debt, we visualize that we would be willing to sell 10 to 15 percent of a county's nonconcessional debt into the market for debt-for-nature and debt-for-equity swaps. For example, of the $5 billion of nonconcessional debt, if 10 percent were sold over a period of years in all the various countries, the elimination would be $500 million. If it were 15 percent, it would be $750 million.

Of course, this will take time to implement on a country-by-country basis. But the results for countries that are heavily indebted on the official side—and that is primarily the medium and smaller sized countries, many of them in Central America and the Caribbean—will be very substantial because the United States is a major holder of official bilateral debt. In many cases we hold 40 to 80 percent of the country's total official bilateral debt. So we are a major player.

Senator SARBANES. Do you have any more, Senator Graham?

Senator GRAHAM. Thank you, Mr. Vice Chairman.

I would like to stay on that point for a minute. I know an example of a country that falls into the definition of high-level U.S. Government debt is Jamaica. Using that as an example, by what time schedule would you anticipate benefits of this negotiation would start to impact on a country like Jamaica?

Mr. MULFORD. Well, Senator, what we need first is the legislation that was sent up on Friday to be passed, because we need four different kinds of authority in order to implement this program. We need the President to be given authority by Congress to make official debt reduction in these countries to cancel the debt. We need authority to receive local currency interest payments. We need authority to create the environmental trust funds into which those local currency payments on restructured debt would be paid. And we need the authorization and appropriation for the multilateral support fund which would be created with the IDB to support the investment reform initiative.

In the case of Jamaica, of course, the country would have to have met the basic qualifications which it, to this extent, either does today or very closely does in the sense that it has an IMF program and it has relationships with the World Bank. It would need to negotiate with the IDB an investment reform program that liberalizes and opens its investment regime.

If Jamaica had done those things, then we would engage in a debt reduction negotiation under the authorities that the legislation must provide. And the effect for Jamaica, which has only about 10 percent of its outstanding debt with commercial banks, could be very substantial.

Senator SARBANES. Is the authority you are seeking to give the President the authority to forgive the debt in its entirety?

Mr. MULFORD. The authority is an authority to cancel debt not in its entirety, but to reduce debt in accordance with the guidelines that are negotiated with the country. The concept here is not to eliminate totally the concessional debt, but to reduce the concessional debt to a level commensurate with the expected and present levels of payment to the United States.

Senator GRAHAM. On the collateral question, one of the aspects of the Brady plan is negotiated with commercial banks on their debt to Third World countries, particularly those in Latin America. And I assume what would be part of this governmental debt negotiation is how to create an environment in which there will be new lending into these countries so that they will have the capital to start serious economic recoveries.

What has been the experience since the initiation of the Brady plan in terms of new lending in Latin America?

What would you anticipate to be the experience in those countries that will be most affected by the new arrangements relative to government debt?

Mr. MULFORD. The Brady plan was introduced, Senator, because the judgment at that time was that the banks were withdrawing from Latin America and were not making new money available. Under the various negotiations that have taken place under the Brady plan in Latin America, the response on new money has been different from case to case.

In Mexico, there was new money provided on a scale that was somewhat smaller than expected. In the case of Venezuela, which has just concluded its negotiation, the new money the banks have come forward with is three to four times what had been originally anticipated when the negotiations were started. So there's a variety of different responses on the new money side.

In the case of Chile, for example, where negotiations are just getting underway on a new bank package, it looks as if they are going to be able to command a substantial amount of new money.

Under the President's Enterprise for the Americas initiative, one of the key concepts is to assume that these countries, in order to finance themselves, are going to have to attract capital other than just new bank loans. They are going to have to attract direct investment, and they are going to have to attract back their citizens' own capital which has left. The key ingredient to that is the reform of the investment regime, the opening of investment regimes along with other macroeconomic policies to create an interest and confidence in investing domestically, and then to reduce part of the large overhang of debt, including the official bilateral debt which acts as a very strong disincentive to investors to reengage in these countries.

And that is why, in a sense, giving the official debt a haircut or reducing its value to a substantially lower level will make, we think, a major impact on the investment incentives and the ability of the country to attract back investment.

Senator GRAHAM. In these countries that have had a tradition of relying on a substantial amount of noncommercial bank lending such as Jamaica, would you see in the post-debt-relief period that they would be sufficiently attractive that they could get their financing from nongovernmental sources, or are they going to continue to require access to government capital for internal investment?

Mr. MULFORD. They would continue to use the IMF and the World Bank as sources. They would continue to receive from the United States bilateral flows which today are in the form of grants. But the debt overhang would be removed, and hopefully the profile of their finance would shift and a higher proportion of it would come from foreign exchange earnings on exports, capital from direct investment inflows, and the recovery of capital that their own people have taken overseas.

Senator GRAHAM. If I could return for a moment to the question of new lending after the Brady plan.

Are you satisfied that the consequences of the changed environment of the Brady plan in the countries in which it has been implemented thus far is generating a sufficient flow of new capital that will allow economic growth at levels necessary to support increased population growth and an increasing standard of living through a more robust economy?

Mr. MULFORD. Well, I am. I think that much depends on the continuing performance of the countries. But if you look at Mexico, for example—whereas I said in the bank package that was negotiated the new money portion came out somewhat below expectations at the beginning, nevertheless, the fact that a package was agreed, that substantial debt reduction and debt service reduction was accomplished resulted in 1989 in Mexico enjoying something like $3 billion of capital inflow and something in the neighborhood of $3 billion of direct foreign investment flowing in.

So the shift in Mexico has been dramatic, and it is not dependent on new loan capital from banks as it was before. And that, after all, is the key to success. Because we need to move away from a situation where these countries were wholly dependent upon the next dollop of new money from banks which thus increased their stock of debt. It is far better for them to depend less on new loans and more on direct investment and repatriated flight capital and export earnings instead of building their stock of debt for new loans.

So I think we have to look—and we have seen this in Chile as well—for situations which result in a reversal of the flows and substantially change the profile of foreign exchange of availability in the country.

Senator GRAHAM. Thank you, Mr. Vice Chairman.

Senator SARBANES. Senator Symms, do you have any opening comments you want to make?

OPENING STATEMENT OF SENATOR SYMMS

Senator SYMMS. Thank you very much, Mr. Vice Chairman. Mr. Mulford, Mr. Wallace, and Mr. Katz, I welcome you here to the committee.

I appreciate the fact that we are having this hearing today, and I think there is no question in my view that a free trade agreement with Mexico and other Latin American countries could be one of the very best mechanisms and vehicles to spread capitalism to that part of world and thereby enhance the opportunities for those people to have a better life.

When one takes a trip—and I understand you're just back from a trip to Latin America, Mr. Mulford—to countries like Argentina, Brazil, and Venezuela, which I am sure you have done, it is distressing to see all the wealth that is available and to see how during the 20th century those governments have managed and monopolized the economy in a way that everybody is made poor, all in the name of social progress. They have had inflation caused by burdensome government regulations and taxes and then, like I say, they do it all in the name of social progress and continue to guarantee that the general population stays poor while just a very few people who have good friends at high levels in the government manage to maintain a very extremely affluent life style. So, I hope that a free trade agreement with Mexico will be a stepping stone for us to help countries in Latin America get into the 21st century on a sound economic footing.

There is no doubt in my mind that what was done in Chile in the seventies and eighties is a positive example of the kind of economic policy that needs to be adopted in other Latin American countries.

So I hope that the promotion of free trade agreements by the United States will induce Latin American countries to be able to see the light and move faster into a global free market in the 21st century.

Now, when you think about it and look back at history a little bit, the United States after the Louisiana Purchase, had no more natural wealth than Latin America has today. Indeed, the Caribbean and Latin American colonies of Spain were advanced at the time of the Louisiana Purchase, but in the subsequent 200 years, they have failed to adopt capitalism and free trade policies which has made all the difference in the world, I believe, in their economic growth compared with ours.

A question I would like to pose would be, how can we expect to have a successful agreement with a country like Mexico that has such a serious currency disorder? I understand Senator Sarbanes raised the issue about Mexican cement dumping into the United States, which I think is a clear-cut case where they are trying to get hard currency.

I was just recently in the Soviet Union and the official exchange rate in the Soviet Union for the United States dollar is at 1.8 rubles per dollar. But on the street—anywhere on the street—it's 15 rubles per dollar. At the rate things are going in the Soviet Union, it won't be very long until the black market—which is really about the only market available—is going to dominate the entire economy.

The question is: In any free trade agreement, will we demand that our partners compete in free trade with each others' currency and how do you plan to handle that currency imbalance between Mexico and the United States or the lack of currency validity?

Mr. MULFORD. This is a question which came up earlier—not the currency question, but first of all the policy question you're raising.

A few years ago Mexico's policies were in such disarray, including its currency, that I think it would have been inconceivable to imagine that we could have negotiated a free trade agreement.

But what has taken place in Mexico these past couple of years under President Salinas is a major economic transformation. They have opened their trade regime, they have liberalized the management of their investment regime, they have put in place sounder macroeconomic policies, they have reduced the level of government interference in their economy, they have reduced subsidies, they have liquidated government companies by the hundreds, privatized a number of them, and for the past couple of years have managed a much more stable currency policy. And those things are critical to a successful relationship between us.

There are still a number of problems that will have to be looked at: Mexico, for example, has a much higher inflation rate than the United States; it presently runs around 20 to 25 percent. They are depreciating their currency, nothing like they did before, but on an average of, I believe, about 9 percent a year. These are still problems. And as we said earlier, we are going to have to get into these broad issues.

But the maroeconomics policy stance of Mexico and the reform of its economy is such that we do think we can negotiate a free trade agreement and look to Mexico to continue following those kinds of responsible policies. I have no doubt that as they proceed with their reforms and improve their performance—growth has moved from 1 percent to 3 percent in the last year, for example—the probability is that the inflation rate will continue to come down and the currency will probably be more stable. That is to say, the rate of depreciation will be reduced. And this problem will be a more manageable problem. It will still have to be discussed, however; I mean it will be part of the discussions to get into that. But it is not the kind of barrier that it could have been 2 or 3 years ago.

Senator SYMMS. So you don't think the greenback would necessarily drive the peso out?

Mr. MULFORD. I don't think necessarily, no.

Senator SYMMS. Do you think if that were the case that the Mexican Government would stand for that? For example, I understand that in Europe 1992, they are going to try to go to a common currency.

Mr. MULFORD. We have not discussed, nor would we as part of this negotiation, the prospect of a common currency with Mexico. Mexico's economy has not been dollarized as other economies have been around the world, and I feel sure that they will maintain their present policies. They will maintain their sovereignty approach on a very strong basis, and they will continue to work toward sound monetary and fiscal policies—which in fact they have made enormous progress; rather more than we have in the last year I would say.

Senator SYMMS. We haven't done all that well in the last year or so.

Mr. MULFORD. That's right.

Senator SYMMS. Ambassador Katz, do you want to make any comments on that?

Mr. KATZ. I would only comment, Senator, that with respect to Europe I think it's important to note the distinction between what Europeans are doing—which is really moving beyond a common market to an economic union. We are nowhere near that. What we are talking about is a free trade agreement which essentially leaves unchanged both what the external tariffs would be and internal policies of the respective countries.

And I think the logic of free trade does drive you to closer integration, but it does not imply any kind of a currency union or economic union.

Senator SYMMS. If they would fail to follow sound policies it could create a problem, wouldn't you think?

Mr. KATZ. The same would be true of us.

Senator SYMMS. Right.

I get concerned that sometimes we're following the Brazilian model by relying too much on bashing the dollar down to correct any trade problems that we have. I think that's a concern we should all have, that we need to approach these trade problems from the standpoint of our efficiencies and productivity and strengths and not try to rely on currency manipulation to solve a problem that may last temporarily but then put us back on the same problem again.

Mr. Vice Chairman, thank you very much.

Senator GRAHAM. If I could just ask one last question.

One of the areas that's clearly going to be a major domestic concern for this will be agriculture. How do you see the United States-Mexico free trade agreement affecting United States agriculture, and what, if any, special initiatives do you anticipate being taken in advance of or in conjunction with a United States-Mexico free trade agreement as it relates to agriculture?

Mr. KATZ. Senator, I would have to say at this point that is not altogether clear. This is one of the issues that we certainly will look at in our prenegotiation consultations.

In the case of Canada, world-traded commodities were really left out of the agreement, and that was because even as important as the United States and Canada are in world grain trade, for example, and trade in meat, we were really more affected by what happened in the world economy at large rather than what happened across the border. Other agricultural commodities were included in the United States-Canada agreement, but with some special adjustment provisions and safeguards.

In the case of Mexico, we think that we would obviously be very competitive in the area of temperate agricultural products. Although there is some production in Mexico, and there is some trade back and forth in terms of meat—or live animals and meat, but in the area of horticulture, Mexico would have a great many advantages, assuming that they can satisfy sanitary or follow sanitary requirements which are a problem in many cases now. So this is an area that we are just going to have to look at much more carefully than we have had the opportunity to do so far.

Senator GRAHAM. Thank you.

Senator SARBANES. Well, gentlemen, we thank you very much. You have been a very helpful panel. We appreciate it.

The committee is adjourned.

[Whereupon, at 12:30 p.m., the committee adjourned, subject to the call of the Chair.]

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