

Peru and Colombia: the Impact of a FTA with the US

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Abstract

This paper will conduct research on the impact of the US – Peru Free Trade Agreement on both the United States and Peru. Taken into account will be the impact on export, import, labor right, biodiversity and the indigenous people. Furthermore, this research will investigate the possible impact of the US – Colombian Free Trade Agreement that was signed recently.

Keywords: Free trade agreement, Peru, Colombia, US, export, import, labor right, biodiversity and indigenous people.

Introduction

Since November 22, 2006 the US government and Colombian governments have been trying to establish a free trade agreement (FTA). Recently, the House Committee on Ways and Means has approved the FTA with a majority of votes. On October 21st 2011 President Obama finally signed the FTA into law. The fact that this process had been taking so long and has had so many draw backs on its way raises the question why this agreement is so important for both countries. In order to understand this, it would be interesting to look at a country that has been able to notice the consequences of such an agreement already. This country is Peru. The paper will begin focusing on the Peru Trade Promotion Agreement, the PTPA, that was signed between the US and Peru. After learning about the Peruvian FTA it will be interesting to have a closer look at what the advantages for Colombia might be after having signed the FTA with the US.

Peru is the fifth most populous country of South America. The population is estimated to be 29.11 million. 74.6 percent of this population lives in the urban areas, with 30 percent living in Lima/Callao. GDP (2009) was estimated at 127.22 billion. Important natural resources in Peru are copper, gold, silver, zinc, fish, petroleum and forestry. Most of their trade income comes from these sectors and their major trade markets are US (17%), China (15.3%), Switzerland (14.9%) and Canada (8.7%). Peru's major suppliers are US (19.7%), China (15.3%) and Brazil (7.7%). Peru has had positive growth in GDP for several years now, with growth of 7.7% in 2006, 8.9% in 2007 and 9.8% in 2009. Besides being in the Peru Trade Promotion Agreement, the PTPA, with the US, Peru is also a member of the Asia-Pacific Economic Cooperation (APEC) and it has been a member of the United Nations since 1949. (www.state.gov, 2010)

Negotiations for a FTA between US and Peru started when the Free Trade Agreements

between the US and four South American countries, Bolivia, Colombia and Ecuador, the Andean Trade Preference Act, the ATPA, later renewed as the Andean Trade Promotion and Drug Eradication Act, the ATPDEA, was about to expire. Although the ATPDEA was extended a couple of times the US had intentions to negotiate FTA with all four of the countries involved in the ATPDEA. Only Bolivia decided not to negotiate a FTA with the US and negotiations with the other three started in May 2004. (Office of the United States Trade Representative, 2007)

Since February 1, 2009 the US and Peru have officially been in a free trade agreement, the PTPA, the Peru Trade Promotion Agreement. A few implements of the FTA are that 80 percent of export of consumer products and industrial products to Peru will be tax free. Also, two third of farm export will become duty free immediately. It will establish a secure legal framework for US investors and it enforces Peru to establish internationally recognized labor rights. Finally, it enforces both countries to commit them to protect their environment. (www.ustr.gov, 2007).

The FTA between Peru and the US is a very useful case when trying to learn about the FTA between Colombia and the US. Both FTA originate from the same agreement and both negotiations started at roughly the same time. Furthermore, Peru and Colombia are very similar when comparing economic indicators. Colombia has a slightly higher GDP per capita (\$8,218.46 for Colombia and \$6,577.66 for Peru) and Colombia's income distribution is a little more skewed (46.1% of income for the richest 10% in Colombia and 35.4% for the richest 10% in Peru). Both countries are ranked as lower middle income countries. (nationmaster.com, 2011)

It would be interesting to see why Peru was interested in starting a FTA with the US and why the US was interested in this FTA. Another important factor to look at is the critics on the agreement. Did all these expectations become reality? What are the expectations of the FTA between the US and Colombia right after the FTA is signed and how do they compare to the expectations for Peru right after they signed their agreement? Are there other comparable FTA's

that might give an interesting perspective to this study? These will be the questions dealt with in this paper. These questions will help getting a better insight into the motivations for signing the FTA between Peru and the US and the FTA between Colombia and the US.

Literature review

Several researches have been conducted concerning the Free Trade Agreements between the United States and both Peru and Colombia. Since the Colombian agreement has not yet been implemented the researches on this subject are still based on expectations. Furthermore, a lot of researched can be found on Free Trade Agreement between other countries that can provide complementary understanding.

William H Cooper (2010) wrote a paper for the Congressional Research Service in which he discusses what Free Trade Agreements are and why countries would want to join in them. In this article a few general expectations and implementations for Free Trade Agreements are stated for the United States. He concludes that almost all Free Trade Agreements are made for economic and political reasons. Most of them encourage trade and promote investment liberalization. Levy (2009) argues in his paper that the intentions of the U.S.- Peru Trade Promotion Agreement was not new market access, but rather promoting investment by locking in Peru's economic reforms and broader integration in the world economy. Levy in his paper takes a Peruvian perspective by using interviews with Peruvian officials. The United States International Trade Commission (2010) conducted an extended research in which they stated the likely effects of the Trade Promotion Agreement between the U.S. and Peru. This article is written right after the agreement is implemented, so the effects were not yet visible. They conducted research on: export and import; employment; and on different industries. They base their expectations on what effect the Andean Trade Preference Act had had on these factors. Their expectations forecasted

both an increase in U.S. imports from Peru and a more significant increase in Peruvian import from the U.S. This research is conducted by an US institute. This means that the facts stated might be biased towards American expectations. Monteagudo et al (2004) wrote a paper in which they study the economic consequences of the agreements between the U.S. and the Andean countries in three separate Trade Agreements: the FTAA, in which the Western Hemisphere eliminates tariff to intra-hemishperic trade, the FTA between CAN and Mercosur, and the individual FTA's between four Andean countries (Colombia, Peru, Equador and Bolivia) and the United States. In their research they only consider tariffs, which might underestimate the positive effect of their outcome. Nevertheless, they estimate positive gains for all Andean countries. To conduct their estimated results they use the 'computable general equilibrium model', which is a multi-country, multi-sector and comparative statistic general equilibrium model with 15 sectors and 14 regions. This model estimates how countries might react to changes in policy. Powell and Chavarro (2008) also conducted a research on the implementations of the TPA between the U.S. and Peru. Their research looked at the consequences for labor rights, biodiversity and the indigenous population. They suggest that governments should 'take small steps towards improved worker rights, protection of the environment and preservation of indigenous cultures'. Joining into a FTA might have dramatic consequences on these areas, so these should be considered in the decision making process.

In order to extend this research by looking at the possible effects of a Free Trade Agreement between the U.S. and Colombia it is interesting to look at a research conducted by Relyea et al. (2011). In this research the advantages of the U.S.-Colombia Free Trade Agreement for both regions are discussed, as well as compared to past experiences of both regions in Free Trade Agreements with other countries. They find that rapid growth gained through this agreement will provide alternatives for violence and trafficking in Colombia. J. D. Robinson

(2011) argues in his paper that the agreement between the U.S. and Colombia, as well as the agreements between the U.S. and both South-Korea and Panama, should have been signed a long time ago. He argues that the fact that not everybody will gain from this agreement, but some people will lose as well, is outweighed by the benefits of freer trade. The most important benefits that should be taken into account are more jobs, higher income and more consumer choices.

J. Rochlin (2011) conducted a paper in which he discusses the effects of the Free Trade Agreement between Colombia and the U.S. on establishing human rights for Colombian labor. His paper focuses on laborers in the petroleum sector. He concludes that it is too early to draw conclusions, but that the FTA will probably have a positive effect on labor rights. Arbeláez, Flórez and Salazar (2006) conducted a research on the U.S.-Colombia Free Trade Agreement focusing on the financial sector implementations. They look at several factors, like the negotiation process, the results and the expected impact on the Colombian financial sector. Since this research was conducted relatively early in the process of the negotiations some of the outcomes might be outdated.

In addition, it is interesting to see how other researches have been conducted on other U.S. Free Trade Agreements that have gone through a process comparable to the one Colombia is going through now. Jeffrey J. Schott (2011) has conducted such a research on the agreement between United States and Korea. He discusses the effects that this agreement is going to have on both countries and why the signing of the agreement had been delayed. He argues that attracting foreign investment is one of the most prominent advantages of the agreement, since this will create competition for the Korean firms and bring the advantages of technology and management practices to the Korean businesses.

All these articles give a good insight in different Free Trade Agreements. Furthermore they all study consequences in different sectors. I would like to combine some of these analysis

and use this for a comparison between the Peruvian Free Trade Agreement and the Colombian Free Trade Agreement.

Analysis

In order to investigate the motives for Peru to enter into the Trade Promotion Agreement with the United States we need to further investigate the data that is available on this subject. To see if Levy was right in stating in his research that the agreement indeed further improved the investment in Peru, we have to look at Inward Foreign Direct Investment data for the country. Chavez and Dupuy (2010) stated that 'Peru has shifted from being a small FDI player in the Latin America and Caribbean region in the 1990s to being the sixth largest FDI host country in 2008'. They support this argument with data retrieved from the UNCTAD FDI/TNC database. This data states that the Inward Foreign Direct Investment flows into Peru have risen from 0.8 billion \$US in 2000 to 4.8 billion \$US in 2009. In order to see if the TPA with the US has had a contribution to this growth we need to divide this data into specific regions and look at the changes in the FDI that came from the United States. In Chavez and Dupuy's data it can be seen that the growth in the world was 12,306 billion \$US to 18,840 \$US, which implies a 53.1% increase. If on the other hand we look at the growth in US IFDI in Peru we see an increase from 2,151 million \$US to 2,760 million \$US, which implies only a 28.3% increase. From this data we can conclude that the US did not have a big contribution to the steep rise in Inward Foreign Direct Investment. From the data we can see that the increase between 2000 and 2009 in IFDI was most impressive from the developing countries with a more than 200% increase and especially from Colombia with an almost 900% increase and from Mexico with an almost 2300% increase. FDI from Singapore went up from 0 to 399, which is due to the FTA between Singapore and Peru signed in 2008. Although there has been an increase in FDI between Peru and the United States, this increase has not been as impressive as changes in other countries and did not have a big contribution to the

growing FDI in Peru. The fact that Peru went through an impressive economic growth during this period makes it more difficult to separate the effect of the TPA with the US from the general economic growth.

The United States International Trade Commission estimated that the TPA between US and Peru would increase US export to Peru by 1.1 billion \$US. The largest increases by value were expected to be in machinery and equipment. US imports from Peru were estimated to increase by 439 million \$US. This increase by value would be mainly in metals. In order to see if these estimates were accurate we need to have a look at the current import and export data for Peru and the US. Data from the United States Trade Representative indicate that export from US to Peru in 2010 were 6.7 billion. This implies an increase of 0.6 billion since 2008, before the FTA. US imports from Peru on the other hand totaled 5.1 billion in 2010. This implies that US imports decreased 0.7 billion since the signing of the FTA. This data implies that none of the above presented estimations of the USITC were adequate. US export to Peru was far below expectations. A reason for the decline in US imports from Peru might be the economic recession the US went through that was not taken into account when predictions were made by the USITC.

Some disadvantages for Peru from signing this agreement with the US are the impacts on labor rights, biodiversity and the indigenous population, like Monteagudo et al. (2004) suggested in their paper. Developing countries are often reluctant to commit themselves on labor right agreements when signing a FTA. They argue that if developed countries stop buying their product because of their underdeveloped labor rights, their local companies will never be able to gain the strength they need to be able to increase wages. They are also afraid that making these commitments might take away their competitive advantage of having cheap labor. They are also unsure about the motivation of the developed countries for their request of labor right improvements. They argue that the motivation for developing counties is to protect their own

domestic industries from having to compete with the cheap labor in developing countries, instead of having concern for the workers. After the agreement was signed there should be rewards for work inconsistent with the nature sensitive way of subsistence lifestyles. CRS report for congress (2007) states that the weakness of the implementation of the Peru TPA labor provisions is the enforcement of the implementations by the Peruvian government. Three of the major weaknesses lie in the lack of protection of the right to organize, forced and compulsory labor practices, violation of child labor laws and non-compliance with minimum wage laws. However, due to the evident majority of votes approving the Peru TPA and the commitment of President Garcia who stated: "It is vital for our country. It is fundamental to continue this path of growth and social redistribution that we have started in my country." CRS believes that improvements will be made in the near future.

The PTPA also has had an impact on the indigenous people. As stated in an article by Foreign Policy in Focus indigenous people have been trying to stop the signing of the Free Trade Agreement by organizing protests. Their main reasons for this is the fact that the agreement will cause the privatization of landownership. Consequently this would open up 45 million hectares of land to foreign investors. This land would mainly be taken away from the locals. Another reason for dissatisfaction was the possible move to privatize water which would be devastating for the poor indigenous population that would not be able to afford this basic need anymore.

Another important subject to investigate is the consequences of the Trade Agreement on biodiversity. The TPA includes a paragraph on the subject of biodiversity. This is the first time any concern for biodiversity is shown in a FTA. This paragraph, an Understanding Regarding Biodiversity and Traditional Knowledge, stimulates the sharing of knowledge on these subjects in order to be able to benefit from mutual understanding. It is particularly important for Peru to have a concern for their biodiversity, since its biodiversity has never been violated before the signing

of the FTA. This FTA might have a devastating effect, when foreign investment becomes a threat for Peru's biodiversity. Despite of the efforts made to take the biodiversity into concern in the FTA, it is still insufficient according to Manuel Ruiz Muller (2006) and further efforts need to be made.

Since the Free Trade Agreement between Colombia and the United States was signed recently, it will be interesting to see why in this case both countries were interested in a mutual trade agreement. Relyea et al (2011) have conducted a research to investigate the motives of the US and Colombia and stated possible advantages and disadvantages for both countries from joining into this agreement. They found that Colombia's total export between 2001 and 2007 increased from 12 billion \$US to 30 billion \$US, while imports increased from 13 billion \$US to 33 billion \$US during this same period of time. US being the biggest importer and export of Colombia had had a big contribution to this growth. Export is critical for economic growth. Therefore, it was very important for the US to stimulate this trade with Colombia, which provides an important export market. Also for Colombia it is important to stimulate trade with the US. This would for example provide great benefits for farm products, which can now receive duty free treatment. A few other impacts of the Trade Agreement are a decrease in unemployment rate and an increase in GDP. A few factors that contribute to the pessimism of the US government for signing the agreement are the violence against the labor unions and the drug cartels. However, Relyea et al. argue that economic growth will possibly be able to reduce this violence against unions and provide an alternative for drug cartels.

When we compare the case of Colombia to the case of Peru we can see similarities. Both countries have been experiencing extensive economic growth over the past years and are trying to stimulate further growth by joining into trade agreements. However, in the case of Colombia there are some issues that need to be overcome before this trade agreement can have a positive

effect on the economy. Both violence against labor unions and drug cartels might alternate this success. In the case of Peru we can see that labor union issues also caused some problems, but due to strong commitment improvements are expected in the near future. For Colombia these improvements are not yet predicted, but if they are able to make the same commitment as Peru they might be able to make some progress in the future. Drug cartels remain a big problem in Colombia. If Colombia is able to make economic progress due to this Free Trade Agreement, it might in the future be able to address this problem properly.

In order to complement this research it is interesting to see Peru and Colombia in a greater perspective in South America. Therefore, data on GDP growth, and import and export with the US for other South American countries could give an extended view on how Peru and Colombia are growing economically compared to these countries. If we look at GDP growth rate data presented by the United Nations, World Economic Prospect and Situation (2011) for South America (see table 1, appendix), we can see that Peru has had impressive growth compared to the other countries, including Brazil and Argentina, which are both countries that have grown extensively during the last decades. Peru has experienced low growth in 2009, but we can see that the other countries in this region also experienced this same economic downturn. This is possibly due to the economic recession all over the world during this year. Colombia has experienced lower, but steady growth during this time period compared to the other countries in the region.

Table 2 and table 3 (see appendix) compare respectively export and import data from the Congressional Research Service (2010) for the US and several South American countries. When we look at export data for US merchandise to South America we see that from 2008 to 2009 there was a decrease in export, however, this decrease for Peru was relatively low when we compare this to the other South American countries. An explanation for this might be the fact that the PTPA was signed in this year. This could have taken some of the severity of the economic

recession away from Peru. When we look at the import data we see again that despite of the economic downturn Peru has outperformed most of the countries in the region. Colombia also has relatively favorable data for both export and import. However, since the agreement was not signed yet during this time, another explanation for this must be sought.

Conclusion

A lot of research has been conducted on the subject of Free Trade Agreements. This research mainly comes from the governments involved in the agreements. Significant criticism has also been provided by parties that might be disadvantaged by these agreements, but critic has also been given by independent parties. However, it is very difficult to draw the right conclusions on the consequences of the specific Trade Promotion Agreement between Peru and the US. While Peru had been growing economically for several years due to different factors before they entered into this Trade Agreement, the US was just entering a period of economic downturn. Therefore, it is difficult to separate the effects from the Trade Agreement and the general economic circumstances. The US economic depression might have contributed to the fact that Peru was not able to profit as much for the agreement as predicted. It will be interesting to conduct further research on the factors that might have had a contribution to the disappointing results of the FTA and if there is significant data to prove that this can indeed be blamed on the economic depression in the US. However, when we compare Peru to the other countries in Latin America, we can see that Peru did relatively well, which might suggest that without the signing of the agreement Peru's economic situation might have been even worse. Colombia on the other hand, had just recently joined into the agreement and the consequences cannot yet be seen. However, a lot of predictions have been made on what are possible advantages and disadvantages for the country. Colombia might experience the same disappointing results as Peru due to the US economic downturn, but predictions for the further future might be more positive. Certain is that research

needs to be done in the coming years to investigate the consequences of the FTA on the Colombian economy. We can conclude that the consequences for Peru of signing this Free Trade Agreement have been disappointing so far. For Colombia the consequences are not clear yet, but the predictions are positive if their major issues of labor union violence and drug cartels can be overcome.

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Appendix

Table 1:

Latin America and the Caribbean: Rates of growth of real GDP, 2007-2012^a

Annual percentage change						
	2007	2008	2009	2010 ^b	2011 ^c	2012 ^c
Latin America and the Caribbean	5.6	4.0	-2.1	5.6	4.1	4.3
South America	6.5	5.3	-0.3	6.3	4.5	4.8
Argentina	8.7	6.8	0.9	8.0	5.0	4.4
Bolivia (Plurinational State of)	4.6	6.1	3.4	4.1	3.9	4.0
Brazil	6.1	5.1	-0.2	7.6	4.5	5.2
Chile	4.6	3.7	-1.5	5.0	6.0	4.5
Colombia	6.3	2.7	0.8	4.5	4.7	4.5
Ecuador	2.0	7.2	0.4	2.4	2.0	2.5
Paraguay	6.8	5.8	-3.8	9.4	5.0	5.0
Peru	8.9	9.8	0.9	8.5	5.5	5.7
Uruguay	7.5	8.5	2.9	8.0	4.5	3.9
Venezuela (Bolivarian Republic of)	8.2	4.8	-3.3	-1.8	2.0	3.0

Source: World economic situation and prospects 2011, UN

Table 2:

Appendix A. U.S. Merchandise Exports to Latin America and the Caribbean, 1998-2009

Country	1998	2000	2002	2004	2006	2008	2009	% Change 2008-2009	% Change 1998-2009
Brazil	15.2	15.4	12.4	13.9	18.9	32.9	26.1	-20.6	71.7
Colombia	4.8	3.7	3.6	4.5	6.7	11.4	9.5	-13.3	97.9
Chile	4.0	3.5	2.6	3.6	6.5	12.1	9.4	-22.3	135.0
Venezuela	6.5	5.6	4.5	4.8	9.0	12.6	9.3	-26.1	43.1
Argentina	5.9	4.7	1.6	3.4	4.8	7.5	5.6	-25.3	-5.1
Dom. Rep.	4.0	4.4	4.3	4.4	5.4	6.6	5.3	-19.7	32.5
Peru	2.1	1.7	1.6	2.1	2.9	6.2	4.9	-7.5	133.3
Costa Rica	2.3	2.4	3.1	3.3	4.1	5.7	4.7	-17.5	104.3
Panama	1.8	1.6	1.4	1.8	2.7	4.9	4.3	-12.2	138.9
Honduras	2.3	2.6	2.6	3.1	3.7	4.9	3.4	-30.6	47.8
Other	14.4	13.4	13.4	21.4	23.7	36.2	27.0	-25.4	87.5

Source: Table created by CRS from U.S. Department of Commerce data

Table 3:

Appendix B. U.S. Merchandise Imports from Latin America and the Caribbean, 1998-2009

Country	1998	2000	2002	2004	2006	2008	2009	% Change 2008-2009	% Change 1998-2009
Venezuela	9.3	18.7	15.1	24.9	37.1	51.4	28.1	-45.3	202.2
Brazil	10.1	13.9	15.8	21.2	26.3	30.5	20.1	-34.1	99.0
Colombia	4.7	7.0	5.6	7.3	9.3	13.1	11.3	-13.7	140.4
Chile	2.5	3.2	3.8	4.7	9.6	8.2	6.0	-26.8	140.0
Costa Rica	2.8	3.6	3.1	3.3	3.8	3.9	5.6	43.6	100.0
Ecuador	1.8	2.2	2.1	4.3	7.1	9.1	5.3	-41.8	194.4
Trin. & Tobago	1.0	2.2	2.4	5.8	8.4	9.0	5.2	-42.2	420.0
Peru	2.0	2.0	1.9	3.7	5.9	5.8	4.2	-27.6	110.0
Argentina	2.3	3.1	3.2	3.8	4.0	5.8	3.9	-32.8	69.6
Dom. Rep.	4.4	4.4	4.2	4.5	3.7	4.0	3.3	-17.5	-25.0
Other	7.6	11.7	10.8	18.4	18.4	29.7	15.9	-46.5	109.2

Source: Table created by CRS from U.S. Department of Commerce data