The Free Trade Area of the Americas Agreement (FTAA)
Issues, effects and implications for the Organisation of Eastern Caribbean States

Re-mapping the Americas
Globalization, Regionalization and the FTAA
19-21 October, 2005
Trinidad and Tobago

Esteban Pérez Caldentey and Anesa Ali (UNECLAC) [1]

Key words: Free Trade Area of the Americas, Organisation of Eastern Caribbean States, CARICOM, export performance ratio, fiscal stance, tariff reduction.

Summary of paper

The Free Trade Area of the Americas (FTAA, hereafter) negotiations involve 34 countries with important differences in size, population, economic structure, economic performance and, stability and welfare. Member countries also belong to different regional groupings with heterogeneous degrees of integration and external orientation. Countries exhibit no other common denominator than that to belong to the Americas in the broadest sense of the term and to be to some varying extent to be economically dependent on the United States market.

The FTAA texts take into account the differences of size and development in the economies. However, thus far the absence of a clear definition of what constitutes a smaller economy has hampered the complete fulfilment of this objective.

In addition, the FTAA texts forget to mention that the initial short-term conditions can also play a fundamental role in determining the costs and benefits of joining a regional free trade agreement and that there is necessarily, at least in the case of the OECS economies, a definite relationship between the internal and the external macroeconomic conditions.

In other words, the outcome of a free trade agreement and the ability of countries to profit and take advantage of a free trade agreement are not independent of the initial conditions. Ultimately the evolution of these conditions may actually determine, in part, both the unfolding dynamics of a free trade agreement, the extent to which countries may be able to fulfil its commitments and obligations as well as its costs and benefits.

[1] ECLAC Sub-regional headquarters for the Caribbean (Port of Spain, Trinidad and Tobago). The opinions here expressed are the authors' own and may not coincide with those of ECLAC. E-mail: eperez@eclacpos.org and aali@eclacpos.org

The present short-term initial conditions of the Organisation of Eastern Caribbean States (OECS hereafter) are: (i) stagnation in growth; (ii) stagnation in domestic investment; (iii) a pattern of foreign direct investment that does not seem to significantly contribute to growth or development; (iv) impending long-term macroeconomic disequilibria including high current account and fiscal deficits and in some cases mounting debt which may lead, in the absence of corrective policies to unstable debt dynamics. This is reflected in a fiscal stance which is systematically greater than the export performance ratio.

These delicate conditions may clearly undermine the benefits of a free trade agreement. Policy choices are far from obvious and the adequate mix will be very hard to strike. Aligning the fiscal stance with the export performance ratio is a complex issue requiring the coordination of short run with long run economic policies. Expansionary policies will have a definite negative effect on the fiscal and external accounts while orthodox corrective policies which are mainly contractive policies may accentuate the present state of stagnation.

On the external front, OECS member states have registered, as an aggregate, a declining trend in imports. Imports do not seem to have responded to liberalisation measures and tariff reductions. In other words, imports do not seem to be price sensitive.

However, the deterioration of export performance over time in both goods and services has not allowed OECS member states to take advantage of this declining import trend to improve their external performance. Thus the empirical evidence suggests that, the reduction in tariffs which will accompany the conformation of the FTAA may be either a non-issue or at the most a minor one when analysing its effect on import growth.

Countries should focus instead on export promotion policies, which is the key to capitalising and capturing the benefits that a FTAA can offer. In this regard, countries need to define clear export promotion objectives and instruments and have a clear understanding of the different type of export promotion policies and their associated costs. Nonetheless, the question remains as to how are OECS economies assumed to be able to develop their export sector under the imbalances and growth stagnation described above. This is a key issue that must be addressed.

FTAA member countries have a weak trading relationship with the OECS. With the exception of the United States and CARICOM, all regional trade groupings represent an insignificant part of OECS trade flows. Moreover, the OECS has a balance of trade deficit with all of the sub-regional groupings. NAFTA explains 75% of that deficit.

Half of the OECS commodity exports to the United States, the main trading partner within NAFTA, enter through the Caribbean Basin Initiative while the other half does not benefit from any preferential access program whatsoever. Still, the export commodities included in the later enter the United States duty free. Thus the main question for the OECS regarding its main trading partner in the FTAA, the United States, is whether the

CBI trading arrangement will still remain in force in the long run or be replaced by similar market access conditions.

The OECS main and most dynamic commodity exports to CARICOM are goods which benefit from a high degree of protection. These form part of the category of goods which are ineligible for duty exemptions. In addition the national production of these goods also benefit from restrictive supply conditions. Thus evidence indicates that intra-regional trade is underpinned by restricted market access conditions. The process of liberalization associated with the FTAA will have a significant impact on OECS intraregional trade with CARICOM as the preferences which form the basis for the intraregional trade impetus are eroded and gradually removed. It will also affect output and employment. Governments should delineate economic policy options to deal with the effects that the removal of tariff will have on intra-regional trade and on the firm structure of the OECS.

The case of services shows a marked specialisation of OECS member surpassing that of any other FTAA regional grouping. This specialisation which has increased over time has been accompanied by market share stagnation or loss and a change in the provision of services favouring the delivery of services through Mode 1. While Mode 2 remains the predominant form of services provision, its contribution to services exports has registered a declining trend since the middle of the 1980's. This can be partly attributed to the deterioration in tourism performance. OECS have lost market to low cost tourism destinations.

Finally the FTAA may impinge on the governments' ability to carry out and implement domestic policy. This is directly related to the decline in tariffs that will take place as a result of the FTAA coupled with the importance of fiscal incentives as one of the main tools for the development of productive sectors. The decline in tariffs will mean that unless governments carry out a fiscal reform or increase domestic taxes, which can act as an economic deterrent to growth and development, these will have to widen the tax base. Other things remaining equal, the greater is the tax base the less is the scope for tax exemptions. Thus in short, the FTAA may neutralise, in part, OECS countries use of fiscal policy as a microeconomic tool for the development of targeted products and sectors.

This potential effect jointly with the issue of initial conditions and the impact of the FTAA on intraregional trade flows and firm structure may in fact be the most important outcomes and those that need the most significant and pressing attention by OECS governments.