1-2008

Institutional Issues Impeding Progress of the Free Trade Area of the Americas Agreement (FTAA)

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ABSTRACT

For any bilateral or multilateral trade agreement to be effective, it is imperative that all participants derive maximum benefit. This paper examines the institutional issues facing the partners of the Free Trade of the Area of the Americas (FTAA), analyzes some of the current areas of conflict and suggests action to reduce tensions and promote harmony, cooperation and accommodation which is a necessity when multiple countries attempt to foster such an agreement.

1. INTRODUCTION

Every nation planning to participate in opening its borders to a trade agreement has by necessity the goal of growth of development through increased trade and commerce void of tariffs and quotas. The nations that are currently party to the proposed Free Trade Area of the Americas agreement (FTAA) are no exception. Each member has unique needs and concerns, but almost all are participating to bring the benefits of free trade down to the level of each member of their community.

Efforts to create this trading bloc began just after the creation of the North American Free Trade Agreement (NAFTA) in 1994 and by most expectations implementation should have materialized on January 1, 2005 the target date set. Not only has this not taken place, questions are being raised if a realistic date can actually be set at all. A recent report in February 2005 is headlined "Is the FTAA Floundering?" and concludes that "the failure to reach an accord by the agreed-upon date could mean there will never be an FTAA." (Meza,, 2005) FTAA talks ground to a halt last year. (Colitt,, 2005)

This paper is another effort in appraising the challenges of trade liberalization in the context of the FTAA, evaluates the issues and concerns of members who are primarily developing economies and suggests overtures that are necessary to address these issues, if there is to be an agreement that will benefit all participants.

2. MULTILATERALISM

The Free Trade Area of the Americas is a progressive and modern effort to remove all barriers to trade and investment by 2005 and thereby unite all the thirty-four economies into one single trade area. Trade liberalization is not completely new to the post-war world and has been introduced in numerous forms. GATT brought the concept of the *most favored nation* (MFN) under the umbrella of multilateralism. As a consequence, protectionist measures though altogether not eliminated were withdrawn equally and in stages in respect of other member nations. Another such move was the formation of Customs Unions. These unions are discrete and so directly violate the principles of multilateralism [Harrison 1979]. Trade liberalization within a small region was also another cooperative effort for promotion of mutual trade. Regionalism is not without contradictions but the countries in the Asia Pacific Economic Cooperation (APEC) have resorted to a policy of open regionalism thereby removing any discriminatory practice [Scollay, 2001]. Preferential trade arrangements (PTAs) cause a fall in tariff levels and this becomes an incentive for new memberships [Freund, 2000] but do result in a diversion of trade [Krishna, 1998]. Exploration of proliferation of free trade agreements in the ASEAN area to promote multilateralism is a policy of the World trade Organization [Sellakumaran, 2004].

Multilateralism by conventional wisdom leads to nondiscrimination and reciprocity [Ethier, 2004] while bilateralism and preferential trade agreements both may lead to trade diversion [Moser, 1995]. The resultant trade growth due to multilateralism promotes output growth and trade liberalization [Greenaway 1990]. For low-income countries, institutional and structural characteristics are more important determinants than multilateral reforms including trade liberalization [Sindzingre, 2005]. Even countries practicing open trade policy could reap the benefits of trade creation through multilateralism. Canada has demonstrated this amply well by entering into numerous unilateral and bilateral trade arrangements and eliminations of tariff [Head and Ries, 2004].

While the FTAA is foreseen to increase the economic welfare of the member countries in varying magnitudes, the rest of the world visualizes it as a tactic of trade diversion. In comparison, unilateral free trade will quadruple the economic benefits to all member countries and a multilateral global trading system adopted by all countries in the world will increase the benefits by 600% [Brown et al, 2005]. Most of the country-specific studies with reference to Ecuador, Colombia and Peru predict significant outcomes in income redistribution caused by changes in factor prices and output prices [Toledo, 2004 & 2005; Thompson et al, 2005].

3. **ORGANIZATIONAL ISSUES**

3.1 Background

The project was launched some fifteen years ago by the then President of the United States George Herbert Walker Bush as a solution that would integrate all the countries in North, Central and South America and the Caribbean. This would have created the world's largest free market, with a combined gross domestic product of US$13 trillion and 800 million consumers from Alaska to Argentina. (Petry, 2004)

The limited success of NAFTA, encouraged by the U.S.'s drive towards maximizing cross border trade, resulted in the signing of the Central American Free Trade Agreement (CAFTA) in December 2003. Another trade agreement – MERCOSUR - tied together the economies of Argentina, Chile, Brazil, Uruguay and Paraguay. The many lessons that have been learnt from the negotiations process, structuring and implementing of these agreements should have resulted in greater success in pursuing FTAA goals, but this does not seem to have been the case. The major differences seem to focus on the fact that there is a great disparity among participating nations. Although the EU does include countries with different levels of development, these gaps are nowhere near as wide as those that exist among member of the 34 diverse countries of the Americas. (Meza, 2005)

3.1. **Distribution of Wealth in Developing Countries**

World inequality remains a real concern for all countries, developed and developing. There exists a great divide among the poor and rich nations and within the countries as well. The divide does not seem to be getting any smaller. World inequality between households has increased. The income of the richest 1% (50 million people) is the same as the income of the poorest 60% (2.7 billion people). The 2002 figures of the number of people living in poverty in Latin America reached 220 million – or 43.4 percent of the total population – and this figure is rising year after year. (Meza, 2005) While countries try to achieve greater equality in the distribution of wealth, incomes and opportunities by broadening access to public services such as education, health, water, electricity and land and rural services, free trade runs completely opposite to the policies of poor countries' attempts at providing the basic amenities to their population through public entities while FTAA presses countries "to privatize health care, water, and electricity and to charge 'user fees' on public services such as education." (Sierakowski et.al,. 2004) The net result of this disparity is the inability for the participants to negotiate on an equal footing.

3.2. Concerns of Labor

The question of labor standards has been plaguing all multilateral agreements including the World Trade Organization (WTO). Labor organizations all over the world are concerned about the exploitation of labor, the degradation of the environment, and the undermining of national regulations designed to protect the health and safety of citizens. (AFL-CIO, 1999) Liberalization of trade necessarily means a restructuring of existing labor policies and standards. Labor organizations are continually in support for linkages of trade and labor standards, though governments of developed countries such as the United States have been hesitant and often strongly opposed. Arguments in favor of linking include:

1. Trade sanctions as an enforcement device. This would raise the enforcement of labor standards and trade can provide a tool for ensuring compliance.
2. Setting efficient labor standards. The fear is that large, capital-abundant countries may set their labor standards at a point where the marginal benefit exceeds marginal cost, thus under-regulating their labor markets.
3. Bargaining inefficiencies. Governments may be motivated to replace inefficient trade policies with inefficient labor policies.
4. Bargaining Complementarities. When countries negotiate on multiple issues, all can gain by linking those negotiations.

Arguments against linkage are:

1. Efficacy of labor standards. This is questioned as whether simply imposing better conditions will in fact make all workers better off. If higher standards are imposed, then the cost of hiring labor will rise and fewer workers will be hired.
2. Trade sanctions may be inappropriately applied. There exists a possibility that trade sanctions will be co-opted for protectionist purposes.
3.

An extensive assessment of these issues done by Brown, Deardorff and Stern in 2002 concludes that “trade sanctions are not very attractive for expressing humanitarian concerns” (Brown et.al, 2002).

Much debate is currently taking place with regards the FTAA and worker rights. Workers through their representatives may be feeling left out as there is not a direct representative serving their needs. The exploitation of labor is a major concern as is the need for proper compensations and benefits. A report on CAFTA “The Real Record on Workers Rights in Central America” released on April 4, 2005 charges that “the labor provisions in CAFTA fall short in at least 20 areas of recognized international labor standards, such as the right to form a union or a ban against child labor.” (AFL-CIO, 2005)

The negative affects of trade liberalization on labor has many supporters both in the developed economies as well as in developing countries. This is becoming a somewhat anti-capitalism fervor, and is resulting in strong protests at meeting venues. Crucial issues raised include the harmful effects of free trade on women and minorities, the fear that investor rights will take tremendous priority over human rights, the existence of sweatshops in Latin America, very low or even no wages, and these continue to be the bone of contention at every level. Various cartoons in the media depicting free trade as the heaven for capital and hell for workers increase the emotional overflow and appeal strongly to sentiments.

3.3. Multilateral Trade and Tariff Issues

The fundamental reason for establishing the FTAA is that trade liberalization will foster economic growth, reduce poverty and speed development. This would necessarily lead to direct benefits to consumers through the competition created by lifting of tariffs and market access. The main concern here is that developed nations, especially in this case the United States, which has comparative advantage in most services such as finance, transportation, engineering, technology, will lead to a tilt in the benefits accrued by some partners.

The one obstacle is the reality that in the face of an overall 34 nation agreement, the US continues to broaden its bilateral and multilateral treaties. One claim is that CAFTA has the potential of paving the way for the FTAA. However, CAFTA has yet to produce the desired results. MERCOSUR is another stickling point in that its participants are not ready to agree to a larger agreement. This has led the FTAA grouping to take on a two-tier approach led by the US and Brazil, the two largest economies who have different priorities. The US is pushing for broad based tariff elimination while Brazil prefers to address peak tariffs and tariff rate quotas (TRQs) (Hornbeck, 2005) The US favors a comprehensive agreement while Brazil aims to keep the talks focused solely on trade.

Another major issue is the subsidies on agriculture which could be the major stumbling block as negotiators are deadlocked in their positions. The issue is further exacerbated by the fact that US does not intend to compromise on this sector, while most of the developing countries depend on agriculture.

The US is pushing for greater market and investment access for its products, a coalition of 21 developing countries is pushing back, demanding an end to agricultural subsidies (Global Fairness, 2005). One of the fears is dumping. The Americas Trade and Development Forum (ATSDF) recommended that FTAA agriculture rules should:

1. Grant all countries the right to develop their own agriculture and food policies, including the right to manage both production and inventories.
2. Grant countries the right to protect themselves from dumping of agricultural commodities at below the cost of production.
3. Prohibit dumping by any country into international markets.
4. Provide farmers with a fair price and consumers with a safe, secure and affordable food supply that is environmentally sustainable.
5. Reduce the anti-competitive market distortions caused by the disproportionate market power of agribusiness cartels. (Institute of Agriculture and Trade Policy, 2003)

However, these recommendations, though noteworthy, have not received due consideration. Up to the time of writing, negotiations have halted; and major differences between the US and Brazil prevail. The contentious area of agriculture remains a major obstacle, especially since both the US and Brazil are major producers and exporters. The parties could agree on different speeds of integration, which will allow them to exclude contentious issues, such as intellectual property rights and agriculture (Ishmael, 2005).

4. FINANCIAL ISSUES

4.1. Currency Problems and Exchange Rates

Many such bilateral, multilateral and regional cooperative measures have their deep roots in the less developed countries' inability to pay for the inevitable imports in hard currencies. These currency problems continued to wreck the soft currencies and the respective balance of payments. Countries in the Nonaligned Movement (NAM) are still being haunted by their colonial past and have been skeptical of the various trade treaties and the wave of globalization while its key member state of India is engaged in a process of systematic liberalization. Despite new currencies with uncertain values, varying degrees of convertibility and divergent exchange rate regimes and restrictions, the erstwhile eastern bloc countries have proved that multilateralism allows non-discriminatory trade [Pomfret 2003]. Financial deregulation in the last decade is another move by the emerging economies to remove the currency problems by series of steps such as economic and financial liberalization, removal of exchange control and restrictions on current account convertibility and introduction of incentives for international investors to provide stimulus for the inefficient domestic sectors. Currency crises in Brazil and Argentina have only reinforced the goals and the need for a common market such as Mercosur [Carranza, 2004].

4.2. Dollarization

Countries in the free trade area have often faced huge trade deficits and in some cases this has added to their pre-existing difficulties of servicing their foreign debt. Severe shortages of dollars and unbridled inflationary trends in the domestic environment have compelled countries like Ecuador to dollarize their economy. El Salvador and Panama have also resorted to substitution of their home currencies with US dollars. Besides losing the benefits of seignorage, the central banks also surrender their autonomy by withdrawing a currency exchange rate mechanism and thereby their tool of intervention. The dollar is not the panacea unless the banking systems in these countries become completely sound, modernized and efficient. Despite the price stability that dollarization may bring to economies in transition, researchers also recommend an optimally managed exchange rate regime to direct the economy at times of fluctuating growth [Hudgins and Yoskowitz, 2004].

4.3. Payment and Settlement Issues

Since most of the countries in the free trade area may agree to invoice the products in US dollar, currency problems may have been resolved but not problems pertaining to payment and settlement. The methods of settlement and the risks associated with international trade are global issues and so a free trade area is not the solution in itself. Technology involving the flows is still being tested and implemented by the developing countries and efforts to unify the systems are yet to be fully envisioned.

4.4. Cross Border Trade Credit

Trade credit is conventional and mostly safe. So, commercial banks will now find a new field for intense competition. The free trade area thus will have to pave way for cross border commercial banks to compete on their levels of efficiency, international interest rates, cost savings to the clients, speedy transfers and also large international presence. The competitiveness in domestic banking sector is prone to increase, yet it might result in dwindling profits and subsequent closure of some institutions. This may lead to a higher impact on credit creation and its multiplier effect. Without an adequate support of insurance and reinsurance, the financial services as a whole sector will be limited in its overall performance.

5. MARKETING ISSUES

The FTAA through the elimination of barriers will provide the citizens of the countries involved with the latest products incorporating the latest technologies at the lowest possible prices. It will do this in two ways: first by allowing foreign firms to compete on an equal basis with local firms. And as a corollary to the first, it will force local firms to upgrade their core competencies in order to compete. The FTAA will provide businesses who buy from other businesses (B-2-B) with additional means to find the right product, at the right place at the right time for the right price. FTAA will do this by reducing and then eliminating artificial impediments to trade - tariff and non-tariff barriers. These barriers forced the buying centers in B-2-B organizations to select products not on the basis of what is best for the organization's core competencies, i.e., latest technology, highest quality, best delivery, internationally competitive price but on the basis local price. This meant that the final product produced by the organizations in a protected environment although competitive within the home country may not have been able to compete internationally.

As the dimensions of the competitive landscape extend beyond national barriers, traditional business models will simultaneously change welcoming improved logistics, advanced technological process and sophisticated marketing trends. The basic concepts of market segmentation, price, product, place and promotion will always hold good, only with more relevance. *Ecommerce* activities will provide better transparency, efficient payment cum delivery systems and a newly developed legal framework.

6. CONCLUSION

The Free Trade Area of the Americas is indeed a timely effort in an age of growing multilateralism. Global trade agreements appear to be farfetched at this time and hence the prevalence of numerous bilateral and multilateral agreements signifying the process of integration. A few powerful countries like the United States may and will however attempt to influence, aid or impede the impact of several existing and proposed regional agreements. A country like Chile may assume the role of a maverick resulting in appreciable impacts on competitive advantages of sources of companies both within and outside of the region [Vachani, 2004; Biggs, 2004]. The derived advantages will certainly be multifold where an agreement includes Brazil which is the largest recipient of foreign direct investment in Latin America from the beginning of this century [Gouvea, 2004].

Environmental friendly regulations may be suggested for inclusion in the integration agreements to appease some arguments against free trade [Deere, 2004]. In sum, the FTAA represents a unified force to reckon with amidst bloc bargaining and sub-regionalism [Phillips, 2003]. As the success of Asia Pacific Economic Cooperation (APEC) as a building block of the World Trade Organization (WTO) suggests, the FTAA is likely to offer a wide range of solutions to international business issues and promote open regionalism [Anwar, 2002]. Besides, several institutional issues, there are numerous forums constantly engaged in vehement opposition to the formation and functioning of the free trade. In our estimate, the waves of opposition will probably cleanse the nationally fragmented systems and bring cohesiveness among diverse democracies.

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