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The United States and Central America Proposed Free Trade Agreement

Implications for the Caribbean Region [1]

On 16 January 2002, United States President, George W. Bush, announced his country's intention to explore the possibilities of engaging in negotiations leading to a free trade agreement (FTA) with the countries of Central America (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua). A free trade agreement would strengthen and deepen the United States' economic ties with that subregion and also would serve as a stepping stone towards the completion of the Free Trade Area of the Americas (FTAA). A FTA with the United States is a long-sought goal by Central America. Bearing in mind that the United States is the main export market for Central American goods (58% of Central America's total exports in 2000) a FTA would allow Central America to develop its export potential and become a basis for higher long-term growth and increased welfare for its population. A United States-Central America free trade agreement may also have important implications for the Caribbean region.

This Brief examines some of the implications of a proposed United States-Central America FTA for the Caribbean. It is divided into three sections. The first centers on the market share evolution and composition of the Caribbean and Central American exports. The second analyses the competitiveness of their top 15 exports. The third section compares the relative strengths and weaknesses of the two subregions in the United States market. The analysis focuses on merchandise trade.

Export performance and evolution

In 1999 Central America's share in the United States import market (1%) was four times greater than that of Caribbean countries (0.26%). At the same time, during the 1990s the composition of exports for Central America registered an important change away from agricultural products and towards textiles (29% and 53% of total exports for 1990 and 1999 - see Table 1). The composition of Caribbean exports did not experience any significant change. In 1990 and 1999, mineral fuels and chemicals were the main Caribbean export products to the United States. A free trade agreement may secure and deepen this process of Central American export diversification and increase its positioning in the United States market.

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[1] In this brief the Caribbean region includes the following countries: Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

Table 1 **Percentage composition of main exports to the United States** **The Caribbean and Central America** **1990 and 1999**		
Product	**1990**	**1999**
Caribbean Countries		
Mineral fuels	**31.6**	**27.5**
Chemicals	**24.8**	**19.8**
Textiles	12.2	14.6
Ores and iron and steel	6.9	7.7
Fish	2.4	6.9
Central America		
Textiles	**28.9**	**53.1**
Boilers	0.9	13.4
Edible fruit	20.1	7.0
Coffee	14.4	5.3
Electrical machinery	2.7	3.0
Fish	5.5	2.7
MAGIC (2000)		

A competitiveness analysis

This section analyses the characteristics of the main Central American and Caribbean export products using the Economic Commission for Latin America and the Caribbean (ECLAC) competitiveness methodology. It classifies products according to four categories (rising stars, declining stars, missed opportunity and a retreat). The purpose is to relate the evolution of a country's product share with the dynamics of the product in United States markets. Rising stars (retreats) combine an increase (a decrease) in the country share in a given product and in the relative importance of that product in the United States imports. Missed opportunities refer to the combination of declining country shares in dynamic products. Finally, declining stars refer to increased country share in products whose importance is declining in the United States market.

A comparison of the top 15 exports of the Central American and Caribbean subregions to the United States at the most disaggregated level available reveals that, with the exception of bananas, Central American countries have increased their market share in the United States for all of its top 15 exports (See Table 2). In fact, the product share for bananas remained constant between 1990 and 1999. Sixty per cent of the top exports of Central America to the United States are rising stars. As expected, the greater majority of these exports belong to the textile and apparel sector. These exports mostly produced in free trade zones have benefited from significant reduction in tariffs and through special and differential treatment provisions allowing a preferential access to the United States market

The Caribbean subregion has increased its country share for most of its exports except for crude petroleum and men's or boys cotton underwear (see Table 3). However, contrary to the Central American case, the bulk of exports from the Caribbean was classified as declining stars, suggesting that the Caribbean's export orientation is biased towards products that are not dynamic (i.e., products with a declining share in the United States market).

Table 2
Top 15 exports of Central America to the United States

Duty rates, changes in country and product share and product qualification

Product description	Duty rate 1999	Duty rate 1990	Change in country share	Change in product share	Product qualification
Parts and accessories of automatic data processing machines	0	0	0.0	1.7	Missed opportunity
Bananas, fresh	0	0	-0.7	0.0	Retreat
Women's or girls' other pullovers knitted or crocheted	15.66	20.78	15.3	0.0	Rising star
Coffee, arabica, not roasted, not decaffeinated	0	0	5.9	0.0	Rising star
Men's or boys' other pullovers, and similar garments, of cotton	9.64	20.54	16.81	0.0	Rising star
Garments knitted or crocheted			18.6	0.0	Rising star
Men's cotton other t-shirts, knitted or crocheted	5.31	20.79	42.3	0.0	Rising star
Men's or boys' cotton underwear t-shirts, knitted or crocheted	4.23	21	14.1	0.0	Rising star
Men's shirts, knitted or crocheted, of cotton	11.14	20.99	-2.1	-0.1	Retreat
Coffee, nesoi, not roasted, not decaffeinated	0	0	3.6	0.0	Retreat
Men's trousers and breeches, not knitted	9.8	17.66	0.0	0.0	------
Men’s trousers and breeches, not knitted	9.80	17.66	30.2	0.0	Rising star
Brassieres, not containing lace	5.27	0.0	18.7	0.0	Rising star
Men’s underpants	2.01	7.90	0.0	0.0	Missed opportunity
Women’s briefs	3.48	8.10	35.1	0.0	Rising star

Source: ECLAC - MAGIC (Module to Analyze the Growth of International Commerce (1990-1999)

Table 3
Top 15 exports of Caribbean to the United States
Duty rates, changes in country and product share and product qualification

Product description	Duty rate 1999	Duty rate 1990	Change in country share	Change in product share	Product qualification
Crude petroleum	0.17	0.43	-1.0	-3.5	Retreat
Anhydrous ammonia	0	0	23.8	-0.01	Declining star
Aliminium oxide	0	0	9.43	-0.18	Declining star
No.6 type fuel oil under 25 degrees	0.38	0.34	2.43	-0.53	Declining star
Natural gas liquified	0	0	36.4	-0.007	Declining star
Aluminium ores	0	0	5.08	-0.05	Declining star
Methanol	0	0.41	14.7	0.04	Rising star
Panty hose and tights	1.02	17.0	5.59	0.021	Rising star
Men’s or boys cotton underwear	3.50	21.0	-23.74	0.047	Missed opportunity
Bars and rods of iron	0	0	13.2	0.057	Missed opportunity
Aluminia blocks	0	0	87.85	0.007	Rising star
Rock lobster	0	0	9.26	-0.025	Declining star
Shrimps and prawns	0	0	3.44	0.025	Rising opportunity
Naphtas, exc motor fuels	0.58	0.26	2.50	-0.153	Declining star
Polystyrene, expandable	0	0	35.9	0.07	Rising star

Source: ECLAC - MAGIC (Module to Analyze the Growth of International Commerce (1990-1999)

Global demand and share effects

This section complements the competitive analysis by an exercise based on a methodology known as **Constant Shares Analysis** for the five main import products of the United States from Central America and the Caribbean for 1990 and 1999. This methodology shows whether an increase in the imports of the United States from Central America or the Caribbean between two years is due to:

i) An increase in United States imports for **all products** from **all regions** including Central America and the Caribbean. This is termed the global demand effect.

ii) An increase in the market share of the imports of the United States from Central America or the Caribbean.

The results show (see table 4 below) that the global demand effect is higher and significant for the Caribbean. For its part, the share effect is not significant for the Caribbean subregion. These results mean that the increase in imports of the United States from Caribbean countries rely mainly on the increase in demand of the United States for **all import products from all countries** rather than on specific market share gains by Caribbean countries in the United States market.

Table 4
Constant Shares Analysis
1990 - 1999

	Caribbean	**Central America**
Global demand effect (000 of US dollars)	725352.8 **Significant relative to Central America**	373368 **Not significant relative to the Caribbean**
Share effect	-0.68 **Not significant for the Caribbean**	1.33 **Significant for Central America**
Note: Computations were carried out on the basis of MAGIC (1999)		

Conclusion

The overall comparative analysis highlights the following implications of a United States-Central American free trade agreement for Caribbean countries.

Central American products are mostly rising stars whereas Caribbean country exports are classified under declining stars indicating that the Caribbean specializes in products with limited development in the United States market. This highlights a greater comparative advantage for Central American countries to gain access to the United States market, which may be deepened and secured by a free trade agreement.

Moreover, a free trade agreement may have a negative impact on the textile exports of the Caribbean to the United States. The increase in Central American textile exports to the United

States has responded in part to the decline in tariff rates (see Tables 2 and 3) and further decreases will only stimulate the growth of Central American textile exports. This will limit the potential sale outlets of the Caribbean apparel industry aggravating an already visible decline of textile exports in some Caribbean countries, notably Jamaica.

This argument, however, is subject to two caveats. First, a free trade agreement has an important cost that must be taken into account when weighing its costs and benefits. It may signify the loss of preferential and differential treatment provisions for Central American countries. This may undermine the present competitiveness of Central American economies, which are based on preferential and differential provisions granted to free trade zones.

The Fact Sheet released by the United States Government on the proposed United States-Central America FTA states that the United States Government expects that the FTA "would be reciprocal, and without a limited term, unlike current statutory trade preference laws, assuring all partners of a long-term outlook that will strengthen North American cooperation with Central America"[2]. Thus, the United States would expect that whatever provisions given to the Central American grouping by the way of opening up of its markets, either by lowering duties and tariffs, it would expect the Central American grouping to do likewise.

Second, and more importantly, both regions export for the most part different goods to the United States. In this sense, if a free trade agreement between Central America and the United States increases the level of trade between both partners, it will not have a significant negative impact on the performance of exports from the Caribbean region. **This export heterogeneity** is compounded by the fact that during the 1990s the Caribbean changed its production structure concentrating on services, while Central American economies remain dependent, to a large extent, on free trade zone exports.

The full effects of a free trade agreement are hard to ascertain and those of a proposed free trade agreement are even harder to delineate. However, the empirical evidence available indicates that the Caribbean should aim at developing its service sector and that its export structure should correspond to its production potential. Such a strategy may outweigh any negative effect arising out of a free trade agreement between Central America and the United States on Caribbean economies.

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[2] United States-Central America FTA Fact Sheet, Pg. 2.