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The Americas

An Unfree Trade Agreement for Central America

By Manuel F. Ayau

Guatemala's President Alfonso Portillo remarked recently that the Central American region has discarded protectionism, recognizing it as a pernicious privilege and a barrier to economic development.

If only that were true. Central America as a region is not moving toward more liberalized trade. Instead, efforts to reach a Central American Free Trade Agreement with the U.S.—CAFTA—are taking our economies several steps backward. While the intentions are good, Central America is on course to accept a voluminous, hyper-regulatory treaty that will be incapable of delivering the growth it requires to climb out of poverty. Indeed, the treaty would cast in stone those privileges that Mr. Portillo condemns.

CAFTA is troubling on two counts. First, as a prerequisite to it, Central American countries have been told that they have to form a common market. This process will prove highly damaging to those countries in the region that had started building momentum toward unilateral opening. Pressure to comply with CAFTA means that the more economically liberal nations in the region are being asked to accept the standards of the lowest common denominators, that is the most protectionist nations, in order to reach consensus.

Second, CAFTA will involve many legal requirements to satisfy labor and environmental interests in the U.S. This effort toward harmonizing legislation is closer to the European economic culture than it is to the diversity of American federalism and it will damage Central America's ability to compete. Moreover, when these restrictions are incorporated into an international treaty they will be more difficult to correct than sovereign decisions would be. Obviously, a truly free-trade treaty would need only the language similar Article Nine in the U.S. Constitution, which guarantees free trade among the states. "No Tax or Duty shall be laid on Articles exported from any State."

The Central American Common Market will have a list of items to be excluded from free trade with the U.S. under CAFTA. The idea here is to protect the interests of a few powerful businessmen who do well by ensuring that consumers have limited choice. This causes much harm to the nation.

Costa Rican economist Rigoberto Stewart estimates that if Costa Ricans could buy rice at world prices they would save some \$70 million per year. There is no way to justify the imposition of such costs by the state in order to benefit the few rich producers. Lowering

the real income of Central Americans also constrains the growth of internal markets and job creation because what people might spend on more and better products instead goes to meet their consumption needs at protectionist prices.

Yet the prevailing sentiment in negotiations is that by opening markets a country “gives” something away. Domestic producers try to protect their own bacon by advancing this myth. When Guatemala tentatively agreed to import certain U.S. products with low duties, Marco Vinicio Ruiz, director of the Business Council of Costa Rica deplored the decision claiming that Guatemala was “delivering” important products to the U.S. “in exchange for nothing.” He also said that the move would “cost millions of dollars to Central American producers whose markets are Guatemala.” His point is that countries should sacrifice the welfare of their people so that producers won’t lose profits.

Proponents of the exclusion list argue that because “on average” the import duties are low, the damage is not significant. Yet the fact is that the products with the highest tariffs and restrictions just happen to be assigned to staples that are locally produced. The average rate is deceptively low but the cost to the public is significant. Moreover, these tariffs will be enshrined in the treaty and will be difficult to correct. This explains why organized industry, which traditionally is against free trade, enthusiastically backs the treaty. By institutionalizing high tariffs, it perpetuates protection.

If we really want to grow richer from trade all we have to do is eliminate custom houses and allow merchandise to be freely traded. This would end trade diversion, introduce international competition, and force local producers to deploy resources to more productive businesses. Living standards would rise as the cost of living came down, contraband would end and with it corruption. To appreciate the magnitude of the benefits a nation would derive, consider how free interstate commerce has enriched America and then just imagine the consequences of having custom houses in every road, railroad, airport, and river port entering every state in the U.S.

A good part of the difficulty in cultivating free-trade practices comes from the fact that most treaty designers are either successful businessmen or bureaucrats with scant knowledge of economics.

Both groups seem to think that imports are only something we must painfully accept in order to have market access for our exports. They are oblivious to the fact that the only purpose of exporting is to generate foreign exchange in order to import. I prefer to call these misconceptions, but the matter may be more serious. It is entirely possible that these arguments are made while knowingly sacrificing the well-being of our people.

Whether it is confusion or something more nefarious, the bad economics have gained currency in public debate. Too many opinion makers believe that if, because of open competition, we shut down uneconomic enterprises, unemployment will follow. Yet in real life the reverse is true. It is the uneconomic allocation of resources that reduces incomes and thus prevents new investment opportunities.

The wiser policy for Central America, as for all small poor countries with little or no internal competition, would be to allow people to purchase whatever they want from whatever part of the world best satisfies their needs and desires. It would be hoped that we could persuade others by example and argument to do likewise and remove obstacles to our exports. But just because other governments sacrifice the interests of their people doesn't mean that, in reciprocity, we must impoverish our own.

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