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The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration

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Summary

On May 28, 2004, the United States signed the U.S.-Central America Free Trade Agreement (CAFTA) with Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. In addition, the Dominican Republic concluded a similar bilateral free trade agreement (FTA) with the United States on March 15, 2004, which is expected to be signed in July 2004 and integrated with CAFTA to be considered as a single legislative package. Enacting the agreement requires the U.S. Congress to pass implementing legislation and that similar action be undertaken in the other countries. As required under Trade Promotion Authority (TPA) legislation (P.L. 107-210), prior to any congressional consideration of implementing legislation, the Bush Administration is required to send to Congress supporting materials within 60 days of entering into the agreement.

CAFTA was negotiated, in part, as a regional agreement in which all parties would be subject to the "the same set of obligations and commitments," but with each country defining its own separate schedules for market access on a bilateral basis. The flexibility of this framework allowed Costa Rica to negotiate longer, and for a slightly different arrangement than the other four Central American countries, each of which also negotiated separate schedules. It also allows for the Dominican Republic to be added at a later date. CAFTA is a comprehensive and reciprocal trade agreement, which distinguishes it from the CBI unilateral preferential arrangement between the United States and these countries. It defines detailed rules that would govern market access of goods, as well as services trade, government procurement, intellectual property, and investment.

Under CAFTA, more than 80% of U.S. consumer and industrial exports and over half of U.S. farm exports to Central America would become duty-free immediately. To address asymmetrical development and transition issues, CAFTA specifies rules for lengthy tariff phase-out schedules as well as transitional safeguards and tariff rate quotas (TRQs) for sensitive goods. Although many goods would attain immediate duty-free treatment, others would have tariffs phased out incrementally so that duty-free treatment is reached in 5, 10, 15, or 20 years from the time the agreement takes effect. Duty-free treatment would be delayed for the more sensitive products, and in some cases, the tariff reductions would not begin until 7 or 12 years into the agreement.

CAFTA is controversial and faces political uncertainty. Supporters hope that CAFTA can be part of a policy foundation supportive of both improved intra-regional trade and long-term social, political, and economic development. Concerns remain, however, over the negative effects on certain sectors and employees of the U.S. economy, and that a balanced outcome may be difficult to achieve if the FTA fails to accommodate sufficiently the adjustment costs also facing certain Central American workers, small farmers, and other groups. The history some CAFTA countries have of poor labor rights enforcement raises questions over whether the labor provisions will adequately promote social development.

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The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration

On May 28, 2004, the United States Trade Representative (USTR) Robert B. Zoellick and trade ministers from Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua signed the U.S.-Central America Free Trade Agreement (CAFTA), formally concluding the negotiation phase (see **Appendix 1**, Chronology of CAFTA Negotiations). Enacting the agreement requires that the U.S. Congress pass implementing legislation, and that parallel action be undertaken in the legislatures of the other countries. Prior to congressional consideration of implementing legislation, the Bush Administration is required under Trade Promotion Authority (TPA) legislation (P.L. 107-210) to send supporting materials to Congress within 60 days of entering the agreement. These include a description of changes to existing laws necessary to bring the United States into compliance with CAFTA, the final legal text, a draft implementing bill, statement of administrative action, and an explanation of how it will meet congressional negotiation objectives set out in TPA.

In addition, the Dominican Republic concluded a similar bilateral free trade agreement (FTA) with the United States on March 15, 2004, which is expected to be signed in July 2004 and integrated with CAFTA to be considered as a single legislative package. CAFTA is a complicated and controversial agreement and because of congressional resistence to it, the Bush Administration does not anticipate sending the agreement to Congress until after the November 2004 elections. This update provides background and analysis on CAFTA, including new information on the Dominican Republic, and will continue to be updated periodically.

Why Trade More Freely?

Countries trade because it is in their national economic interest to do so, a proposition long supported by theory and practice. Comparative advantage has been recognized for nearly 200 years as a core principle explaining the efficiency gains that can come from trade among countries by virtue of their fundamental differences. It states that countries can improve their overall economic welfare by producing those goods at which they are relatively more efficient, while trading for the rest. Intra-industry trade is the other major insight that explains trade patterns. Larger markets allow for benefits from exchange among countries to occur based on specialized production, product differentiation, and economies of scale. Many Latin American countries have liberalized trade policies recognizing the contribution that trade (and related investment) can have on economic growth and development. As an important caveat, trade is at best only part of a broad development agenda, which must also

include promotion of political freedom, macroeconomic stability, sound institutions, and adequate levels of savings and investment, among many other factors.[1]

Comparative advantage and perhaps intra-industry trade provide the rationale for U.S.-Central American (and Dominican Republic) trade. Comparative advantage is at the heart of exchange between developing and industrialized countries, such as Central America trading fruit and coffee for U.S. grains, cereals, and capital goods. Intra-industry trade (e.g. goods within the same harmonized tariff system (HTS) code number) is based on specialized production, but in this case relies in large part on differences in wages, skills, and productivity.[2] Certain specialized jobs have developed in Central America (and other developing countries), where they frequently reside in production sharing (maquiladora) facilities. Economists have come to refer to such specialized production as "breaking up the value added chain" and it accounts for why products (and particularly parts thereof) as diverse as automobiles, computers, and apparel are often made or assembled in Central America and other countries in partnership with U.S. firms.[3] This relationship, discussed in more detail later, provides the basis for much of the labor policy debate on CAFTA, and FTAs more generally.[4]

Measuring the benefits of freer trade is another difficult issue. There is a tendency to count exports, imports, and the oft-misrepresented importance of the trade balance as indicators of the fruits of trade. This approach often gives undue weight to exports at the expense of understanding benefits from imports, where the gains from trade are better understood by their contribution to increased consumer selection, lower priced goods, and improved productivity. For example, high-tech intermediate goods imported from developed countries are the basis for future, more

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[1] The role of trade is summarized well in: Rodrik, Dani. *The New Global Economy and Developing Countries: Making Openness Work*. The Overseas Development Council, Washington, D.C. 1999. p. 137 and Bouzas, Roberto and Saul Keifman. Making Trade Liberalization Work. *After the Washington Consensus: Restarting Growth and Reform in Latin America*. Kuczynski, Pedro-Pablo and John Williamson, eds. Institution for International Economics. Washington, D.C. March, 2003. pp. 158, 165-67.

[2] This case differs from the standard intra-industry case between two developed countries in which goods, such as automobiles, are exchanged based on product differentiation and economies of scale and where differences in wage levels are not a central factor.

[3] For the theoretical foundation, see Krugman, Paul. Growing World Trade: Causes and Consequences, in *Brookings Papers on Economic Activity (1)*, William C. Brainard and George L Perry, eds. 1995. pp. 327-76 and for the case in Central America, see Hufbauer, Gary, Barbara Kotschwar, and John Wilson. *Trade and Standards: A Look at Central America*. Institute for International Economics and the World Bank. 2002. pp. 992-96.

[4] Note that this trend has not been a driving force in the aggregate unemployment rate of the United States, but does affect the distribution of employment among sectors of the economy. It is also important to emphasize here that wage levels are only part of the issue. Lower wages correlate closely with lower productivity, hence an abundance of low-skilled (low productivity) workers attracts these types of jobs. For a recent overview of the methodology of measuring the effects of changes in trade policy, see Rivera, Sandra A. Key Methods for Quantifying the Effects of Trade Liberalization. *International Economic Review*. United States International Trade Commission. January/February 2003.

sophisticated, production in developing countries. In developed countries, imports from developing countries, whether final goods for consumers or inputs for manufacturing enterprises, reduce costs and contribute to productivity and economic welfare. For all countries, exports are the means for paying for these imports and their attendant benefits.

Three caveats related to negotiating FTAs are important. First, the discussion of costs and benefits generally assumes that FTAs are executed and implemented in a multilateral setting. In fact, given the slow pace of World Trade Organization (WTO) negotiations, many countries are pursuing preferential arrangements, that is, regional and bilateral agreements like CAFTA. Latin America is full of them and depending on how they are defined, they may actually be trade distorting if they promote trade diversion. This occurs when trade is redirected to countries within a limited agreement that does not take into account countries outside the agreement, some of which may be more efficient producers. Preferential trade agreements are also cumbersome to manage, requiring extensive rules of origin, and economists disagree over whether FTAs help or hinder the movement toward greater multilateral trade liberalization.[5]

Second, trade, much like technology, is a force that changes economies. It increases opportunities for internationally competitive sectors and challenges import competing firms to become more efficient or do something else. This fact gives rise to the policy debate over adjustment strategies, because while consumers and export sector workers benefit, some industries, workers, and communities are hurt. Economists generally argue that it is far less costly for society to rely on various types of trade adjustment assistance than opt for selective protectionism, the frequent and forcefully argued choice of trade-affected industries. The public policy difficulty is that both options have costs and benefits, but result in different distributional outcomes.[6] Because trade agreements raise difficult political choices for legislators in all countries, many of whom represent both potential winners and losers, FTA provisions are typically limited in scope (so continue to protect partially or completely certain products, industries, or sectors) and are phased in over time (typically up to 15 years for very sensitive products).

Third, there are clearly implications in the trade negotiation process for smaller countries' bargaining leverage when they choose to negotiate with a large country in

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[5] U.S. businesses operating in Latin America have had to interpret a difficult road map when dealing with multiple arrangements such as the Caribbean Basin Initiative, the Andean Trade Preference Act, and the North American Free Trade Agreement. Each distorts investment decisions in the region and can have a countervailing influence on the others. Adding the many Latin American FTAs only makes the situation more confusing.

[6] Importantly, when a staple, such as underwear, is produced abroad and sold in the United States as a lower-priced import compared to a domestically produced good, it is equivalent to an increase in real income for the U.S. consumer. This can be significant for low-wage workers in the United States. The same idea holds true for industrial products and business consumers. So, there is a "trade off" in the trade policy decision between keeping certain jobs through protection and losing the income gains, or keeping the income gains and losing certain jobs. One public policy response has been to pass trade adjustment assistance legislation to help firms and workers transition more quickly to new opportunities.

a bilateral rather than multilateral setting. Both Chile and the Central American countries realized early in the process that there were negotiating issues over which they would be able to exert little or no leverage. Both agreements deal little with trade remedies (e.g. antidumping and subsidies) and resolving agriculture issues also has been limited, given the politically sensitive nature of this issue.

The Impetus for a CAFTA

The United States moved decisively to negotiate preferential trade agreements with Central America and the Dominican Republic. In part, this decision was influenced by external events, as well as broader strategic interests. With the proliferation of regional agreements around the world, trade negotiations for some countries have become a tactical issue of picking off gains where they are perceived relative to what other countries are doing. In response to this, it was repeatedly argued by the U.S. business community that the U.S.-Chile agreement, for example, was necessary to equalize treatment of U.S. businesses competing with Canadian firms that already enjoyed preferential treatment with Chile. The case was made for Central America as well, which has trade agreements with Mexico, Canada, and other countries. The apparent impasse or delay of WTO and possibly the Free Trade Area of the Americas (FTAA) negotiations only reinforces this attitude.

In the context of regional trade agreements, history, geographic proximity, and economic complementarities also combine to make the formal deepening of trade relations between Central America and the United States an apparently logical step.[7] At least three cautionary notes, however, bear keeping in mind. First, because of a historical pattern of U.S. political, military, and corporate intervention in the region, a sense of disparity in power between the two partners lingers, which carried over to the trade negotiations themselves. Second, intra-Central American squabbles and instability have at times disrupted regional integration and especially foreign trade relations. Third, it is easy to raise expectations of the effects of trade agreement on broader social, economic, and political reform that some have proposed.

Economic fundamentals have shaped Central American trade relations. From the early days of independence, agricultural exports were the centerpiece of Central American economic growth. The British controlled primary export production (coffee, bananas, sugar, and beef) until about 1850, when U.S. interests won over. This continued until the 1980s when passage of the Caribbean Basin Economic Recovery Act (CBERA — P.L. 98-67) began to transform the Central American and Dominican economies. By becoming eligible for unilateral preferential tariff treatment as part of the Caribbean Basin Initiative (CBI), U.S. investment fostered growth in light manufacturing, primarily apparel.[8]

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[7] For an excellent economic history of the region, see Woodward, Ralph Lee Jr. *Central America: A Nation Divided.* New York: Oxford University Press, third edition, 1999.

[8] This legislation was amended twice, most recently by the Caribbean Basin Trade Partnership Act (CBTPA — P.L. 106-200, Title II), which further loosened restrictions on apparel imports from the Central American countries.

The U.S.-Central American/Dominican Republic economic relationship changed dramatically under the CBI, creating an environment in which businesses forged strategic partnerships in the increasingly complex world of textile and garment manufacturing. From 1974 until 1995, rules restricting trade in apparel between developed and developing countries (mostly quotas) were set out in the Multifiber Arrangement (MFA). Its successor, the WTO sponsored Agreement on Textiles and Clothing (ATC) serves as a transitional agreement that oversees the reduction and elimination of quotas by January 1, 2005.[9] The CBI preferential arrangements were defined under this system, which the United States created to help foster Caribbean economic development, as well as to assist U.S. industry in responding to competition from similar production-sharing arrangements in Asia that were taking a toll on U.S. production and employment in the textile and apparel industries.

Both U.S. textile and apparel industries have been hit hard by foreign competition. The textile industry (e.g., cloth, yarns, thread) has lost jobs, but has remained marginally competitive internationally through more sophisticated use of production technologies. The apparel manufacturing industry (e.g., shirts, pants, undergarments) by contrast, is highly labor intensive, and in striving to reduce costs, has moved production offshore to lower wage countries, with significant U.S. job loss in that sector. As part of this process, and with the added incentive of CBI benefits, U.S. firms invested in Central American and Caribbean countries to develop assembly businesses that used mostly U.S. textiles as inputs. Although created as a mutually beneficial pact, it was a controversial move because of the reliance on foreign low-wage workers to the detriment of some U.S. employment. Many economists argue, however, that the alternative would have been an even greater loss of textile and garment jobs to Asian countries that use no U.S. inputs.[10]

Low-cost labor, however, is not the only, or even the most important, factor driving competitiveness. Studies suggest that the economic and social networks that developed between U.S. and Central American firms effectively created a comparative advantage for the region in apparel exporting that has held up even with the entry of China in the market.[11] The key global challenge to this system comes after 2004 when quotas are scheduled to end on textiles and apparel. Whether the U.S.-Central American production relationship can withstand the expected increased

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[9] See CRS Report RL31723, *Textile and Apparel Trade Issues*, by Bernard A. Gelb.

[10] Chacón, Francisco. International Trade in Textile and Garments: Global Restructuring of Sources of Supply in the United States in the 1990s. *Integration and Trade*, Vol. 4, No. 11, May-August 2000. Inter-American Development Bank, Washington, D.C. and United States International Trade Commission. Production-Sharing Update: Developments in 2002. *Industry Trade and Technology Review*. November 2003. p. 12.

[11] A more subtle distinction made by one economist notes that, "How comparative advantage is created matters. Low-wage foreign competition arising from an abundance of workers is different from competition that is created by foreign labor practices that violate norms at home. Low wages that result from demography or history are very different from low wages that result from government repression of unions." See Rodrik, Dani. "Sense and Nonsense in the Globalization Debate." *Foreign Policy*. Summer 1997. p. 28.

competition from large low-cost producers, such as China, is unclear, but CAFTA is seen by some as a logical policy extension of a model intended to do so.[12]

Broader geopolitical and strategic concerns also sparked interest by all parties in pursuing CAFTA. For example, proponents expect CAFTA to reinforce stability in general by providing institutional structures that will undergird gains made in democracy, the rule of law, and efforts to fight terrorism, organized crime, and drug trafficking. CAFTA may also be a way to expand support for U.S. positions in the FTAA, and in the event that the FTAA is delayed beyond its 2005 deadline, help rationalize the system of disparate preferential trade agreements that currently define Central American trade relations.

Critics of CAFTA point to equally broad themes, such as the pervasive social and economic inequality in much of Central America, and so support labor and environment provisions as important negotiating objectives. There is concern, for example, over the adequacy of working conditions and core labor rights and whether CAFTA can help change the situation, a reflection of the whole issue of "civil society's" role in the trade agreement that developed early in the negotiation process. The broadest possible support for CAFTA is unlikely to materialize unless there is some credible promise of accelerated social development, even if this is much to ask of a trade agreement.

Strategic justifications may have helped get the process going, but ultimately it is fair to ask what each side expects to gain commercially from the detailed agreement that has emerged. The dollar value of U.S. trade with Central America makes the region the United States' third largest Latin American trading partner; right behind Brazil, although a distant third from Mexico. Although firms engaged in this trade may find its effects significant, total CAFTA trade represents less than 1% of U.S. foreign commerce, and so would have only a small macroeconomic effect.

For the United States, an FTA is a more balanced trade arrangement than the unilateral preferences provided in the CBI. Market access (e.g., tariff rates, rules of origin) was a core negotiating area. Although Central American tariffs are already relatively low, they can be reduced further. In particular, U.S. business interests want equal or better treatment than that afforded to exports from Canada and Mexico based on their FTAs with Central American countries. Permanent and clarified trade rules would also support the joint production arrangements already in place between Central American and U.S. firms. Finally, as highlighted in the negotiations with Chile, a bilateral agreement offers the United States a chance to address other trade barriers that affect some of its most competitive industries. This includes clarifying rules for the treatment of intellectual property, foreign investment, government procurement, e-commerce, and services.

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[12] Gereffi, Gary. The Transformation of the North American Apparel Industry: Is NAFTA a Curse or a Blessing? *Integration and Trade*. Vol. 4, No. 11. May -August 2000. Inter-American Development Bank. Washington, D.C. pp. 56-57.

From the Central American perspective, reducing barriers to the U.S. market (especially for textile and agricultural products) and increasing foreign investment were cause enough to proceed. This point is directed specifically at making permanent the benefits Central America currently enjoys under the CBI legislation, but which requires periodic reauthorization by Congress. This could increase U.S. foreign direct investment (FDI) that developed the maquiladora relationship in the first place and which supports Central America's export driven development strategy. The Central American countries also faced important vulnerabilities, such as the possibility that U.S. agricultural exports of key staples, such as corn and rice, might overwhelm their small markets, causing huge displacement issues. Sensitivity to these and other key industry sectors had to be considered.

Finally, two factors pointed to significant negotiation challenges. The first was the need for better Central American integration. Individually, the Central American countries may be too small to justify a U.S. bilateral agreement by themselves, and also trade has been hampered within the subregion by cumbersome customs and other rules. For CAFTA to work well, the United States needed some assurance that goods could flow efficiently within the region. Second, much was made of the difference in negotiating capacity between Central America and the United States. U.S. and multilateral offers to assist these countries in developing such capacity were viewed as generous, but also a little self-serving, which required a sensitive approach to the whole negotiation process.

The Quest for Central American Integration

Because the Central American countries had to negotiate together, cooperation was paramount. This is no small technical point; although the Central American Common Market (CACM) has been in place for four decades, historically the member countries have struggled to define unified positions in trade, a natural consequence of trying to reconcile diverse national interests and economic capabilities. The fact that Costa Rica took longer to conclude an agreement makes the point.[13]

Since the Spanish colonial period, Central America has been an agricultural exporting area, which by the modern period became concentrated in five major commodities: bananas; coffee; sugar; beef; and cotton. The socioeconomic balance that emerged from this trade regime was far from egalitarian. Economic gains have been uneven. Concentrated land ownership led to highly skewed patterns of income and wealth. Although underlying inequality was an inherent part of colonial Central American society, the modern, foreign-dominated agricultural export model did little to change this reality. The resulting highly stratified socioeconomic structure fostered social discontent and political unrest, leading directly, and perhaps

[13] This is not to suggest that all five countries were expected to strike the exact same bargain with the United States in all cases, but that there was agreement among them regarding how the final agreement was defined.

unavoidably, to the turbulent 1970s and 1980s (see **Appendix 2** for a comparison of economic data among the five countries).[14]

There are important implications of this development pattern for regional integration. The emphasis Central American leaders placed on economic integration rested largely on expectations that the gains from economic growth and development would be shared, at least among countries, if not within them. In the first two decades of the CACM, economic analysis pointed to both static and dynamic gains from trade. The CACM lowered and equalized external tariffs, expanded the internal market, and helped diversify production and modernize economic activity. Benefits arose from more open domestic policies as well as foreign investment and technology transfer that accompanied trade. One study found that some of these gains were shared broadly, as seen in lower prices and a greater selection of goods. Economic integration, however, was not realistically expected to change the underlying social and economic stratification that had dominated for centuries. What the CACM did accomplish was to address, in part, the lack of opportunity that defined small closed economies, presumably without introducing new distortions in trade relations.[15]

These gains were widely applauded in the first decade and *intraregional* trade grew eight-fold from 1960 to 1968, when it peaked at 24% of total Central American trade. After that, the CACM struggled as a unifying force for the region. Unequal growth and development patterns eventually undermined the common market, largely because of disappointment over efforts to achieve its unwritten, but widely accepted goal of "balanced development." Historical inequalities among the five countries, most evident between the two extremes of a relatively wealthy Costa Rica and a far poorer Honduras, gave rise to chronic balance of payments problems. As economic growth in Honduras continued to lag behind the rest, it pressured the common market members to find a policy solution to the growing disparity in economic performance.[16]

Unequal economic performance gave way to heated political debate and eventually military conflict. The "Soccer War" between El Salvador and Honduras, begun during the 1969 World Cup playoffs, was a major setback for the CACM because the heart of this conflict was economic, arising out of long-term tensions over land disputes and immigration pressures. The hostilities, although short-lived, had lasting economic effects, with Honduras pulling out of the CACM and suspending trade with El Salvador for over a decade. Despite these setbacks, economic analysis strongly suggested that where reduced restrictions to trade were

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[14] An excellent discussion on the effects of the agricultural export model from a historical basis may be found in: Brockett, Charles D. *Land, Power, and Poverty: Agrarian Transformation and Political Conflict in Central America*. Boulder. Westview Press, second edition, 1998. See especially pp. 93-94.

[15] Cline, William R. and Enrique Delgado, eds. *Economic Integration in Central America*. Washington, D.C. The Brookings Institution, 1978. pp. 405-10.

[16] Ibid., pp. 30-45 and Carl, Beverly M. *Trade and the Developing World in the 21st Century*. New York, Transnational Publishers, Inc, 2001. p. 106.

allowed to operate, net welfare gains could be found for all countries, even if not shared equally.[17]

The 1980s led off with the fall of the Somoza dictatorship in Nicaragua, civil war in El Salvador, the 1982 Latin American debt crisis, and military repression in other parts of Central America. Between a growing political mistrust and the collapse of economic fundamentals, intraregional trade was halved by 1986, falling to 15% of total trade. Policies meant to correct foreign debt buildup and balance of payments problems resulted in increased non-tariff barriers, reducing trade growth throughout the region. Over time Central America moved away from low value-added primary-goods exports, and through this diversification process, there emerged a renewed sense that the region would be served better by engaging the world as a bloc, rather than individually.

As with most of Latin America, it took more than a decade for Central America to recover economically from the 1980s downturn (see **Appendix 2**). A revived commitment to deeper integration was codified in the 1991 Protocol of Tegucigalpa that established the Central American Integration System, which operates as a regional umbrella organization and includes Panama. Since then, most Central American countries have experienced noticeable increases in trade as a percentage of economic activity (see **Table 1**), although at levels that still leave much room for growth, especially for countries with small internal markets.

Table 1. Central American Exports as % of GDP

Country	1991 Exports/GDP	2001 Exports/GDP
Costa Rica	22.8	31.0
El Salvador	11.3	20.8
Guatemala	12.8	14.2
Honduras	26.7	31.7
Nicaragua	21.4	32.6

Data Source: IMF, *International Financial Statistics*, and Central Banks of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

In 1993, the Protocol of Guatemala modified commitments of the original CACM treaty, calling for deeper economic and political cooperation. This took form in policies such as establishing a new common external tariff (CET) with a floor of zero and a cap of 15%. This and other rules, however, were phased in at the discretion of each country, so the prospects for deeper integration rests on a

[17] Cline and Delgado, op.cit., pp. 22-23, 39-41, 110-15, and 296-300. Honduras actually raised its tariffs for all CACM members and then proceeded to negotiate more limited bilateral agreements with individual CACM countries, with the exception of El Salvador. The Central American Bank for Economic Integration took responsibility for providing resources to address uneven development issues. Interestingly, Honduras had the highest level of outstanding loans (relative to total economic output) in the first two decades, but this had failed to keep hostilities at bay.

foundation of flexibility that has served to unify the member countries by recognizing their varying abilities to implement the agreement's provisions.[18]

This flexibility has been useful in CACM's trade agreement negotiation process as well. The CACM has initiated negotiations for FTAs with both Chile and the Dominican Republic, among others, setting a precedent for intra-regional cooperation in trade negotiations. Individual countries, however, are also pursuing bilateral agreements with various Latin American countries, again pointing to the fluid nature of the CACM, but also blurring the distinction between the CACM operating as a free trade area rather than a customs union with a well-defined and fully observed common external tariff. This system raises a number of potential legal confusions for international firms wishing to trade or operate in one or more of the Central American countries.[19]

Such a concern has not been lost on the CACM countries. On March 24, 2002, they signed a plan of action to move forward on integration issues including tariff harmonization, reducing non-tariff barriers, finalizing dispute settlement procedures, and developing a common foreign trade policy.[20] Although it is unclear how soon all these goals can be reached, the continuing commitment to regional integration remains alive.

U.S.-CAFTA Country Trade Relations

"Docking" the Dominican Republic FTA to CAFTA adds the largest of what would be six trading partners covered by the two agreements. U.S. exports to the Dominican Republic are nearly 25% greater than Costa Rica's, the largest U.S. trading partner in Central America. What makes the process feasible is the Dominican Republic's willingness to accept the basic framework and rules of CAFTA, while negotiating market access and other issues bilaterally, as was done with each of the five Central American republics. In addition, the Dominican Republic's economy and export regime are, in many ways, similar to those of Central America. U.S.-Dominican Republic trade has been added to this report and is discussed separately.

U.S.-Central American Trade

Because of its huge size and geographical proximity, the U.S. market has been a natural destination for Central American exports. Merchandise trade with the United States has dominated Central America's foreign commerce for 150 years, and as seen in **Figure 1**, remains in that dominant role today. The United States is by far the largest of Central America's trading partners, accounting for some 57% of its

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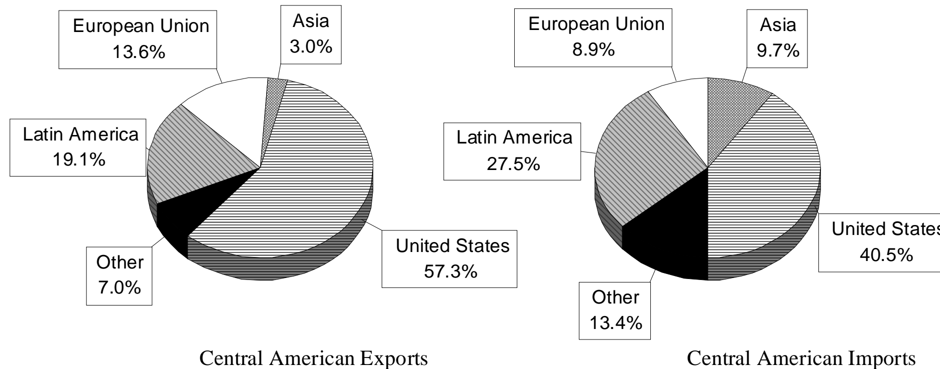
[18] Inter-American Development Bank. *Integration and Trade in the Americas: Periodic Note*. Washington, D.C. December 2000. pp. 34-35.

[19] Ibid., p. 35-36 and Carl, op. cit., pp. 110-11.

[20] Inter-American Development Bank. *Institute for Integration of Latin America and the Caribbean. Monthly Newsletter*. April 2002.

exports and 41% of its imports. The rest of Latin America collectively is the next largest trading partner, accounting for 19% of Central America's exports and 28% of its imports. The European Union and Asia together account for about 17% of Central American exports and 19% of imports.

Figure 1. Central America's Direction of Merchandise Trade, 2002



Data Source: IMF, *Direction of Trade Statistics*, September 2003.

This distribution is not uniform throughout the region. Honduras, for example, exports 70% of its merchandise goods to the United States, compared to 45% for Costa Rica. Honduras also has the highest import percentage from the United States at 55% compared to Nicaragua's 24%, which is the lowest. Total trade (exports plus imports) with the United States is also somewhat uneven country by country. Costa Rica accounts for one-third of total Central American trade with the United States, whereas Nicaragua amounts to only 7% of the total. Guatemala, Honduras, and El Salvador account for 25%, 22%, and 12% respectively.

Trade volume with the United States varies among countries, but in most cases the trend has been one of growth at a rate higher than the average for U.S. trade with the world. Over the past six years, U.S. exports to Central America grew by 29.2% (22.1% including the Dominican Republic), compared to 6.1% with the world and 5.2% with Latin America as a whole (see **Appendix 3** for the data). U.S. imports from Central America increased by 34.1% (23.1% including the Dominican Republic) over the same time period, compared to 38.1% from the world and 49.7% from Latin America.

For 2003, although trade growth varied among the five countries, U.S. export growth to Central America far exceeded average export growth to the world. U.S. merchandise exports to the world expanded by 4.4%, whereas exports to Central America grew by 10.4% (7.0% including the Dominican Republic), with all five countries experiencing solid growth. U.S. imports from Central America, by

contrast, grew at a much smaller rate than average import growth from the world. U.S. imports from the world advanced by 8.4% in 2003, compared to 4.6% from the Central American countries (5.2% including the Dominican Republic), all of which experienced growth in the U.S. market over the last year.[21]

As these trends suggest, the United States tends to run small merchandise trade deficits with all the Central American countries and the Dominican Republic. In part, this is the nature of a production-sharing trade relationship, where parts and materials are sent abroad for value-added processing and then returned to the United States. Importantly, when services trade is added to the trade balance, the United States tends to run trade surpluses with all these countries. This trend, too, is indicative of the basic relationship between the United States, a service-based economy, and developing countries.[22]

U.S. Imports. The major U.S. imports from Central America fall into three main categories: fruit (mostly bananas) and coffee; apparel; and integrated circuits. These three distinct categories, for various reasons, are not traded uniformly by the five countries (see **Table 2**). First, Central America has traditionally exported bananas and coffee, which is dominated by Costa Rica and Guatemala. Coffee has actually declined for all countries except Costa Rica and constitutes only 3.2% of U.S. imports from the region. This reflects the competitive nature of trade in coffee, which is grown in vast quantities by Brazil, Colombia, and countries in Africa as well. Banana trade has also declined in importance and accounts for only 5.4% of U.S. imports from Central America.

Second, apparel has become the primary export good for all countries except Costa Rica and accounted for nearly 60% of total U.S. imports from Central America in recent years. As discussed above, the U.S. Congress has encouraged this trade by enacting the CBI program in 1984, and amended it most recently in the CBTPA in 2000. Over 75% of apparel imported from all eligible countries in 2002 was sewn from U.S. fabric and 95% of the amount that entered duty-free came from CAFTA countries. This amounted to 79% of total apparel imports (including non-production-sharing apparel imports) from eligible Caribbean countries in 2002. Honduras had 28% of the total, followed by the Dominican Republic with 27%, El Salvador with 19%, Guatemala with 11%, Costa Rica with 9%, and Nicaragua with 2%. Under the CBTPA, these countries may engage in greater value-added operations such as cutting and dyeing, which has allowed them to remain competitive with low-cost Asian exports.[23]

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[21] Calculations are made from trade data compiled by the U.S. Department of Commerce. Merchandise trade data have a two-month lag time from the time the goods enter the country until they are reported. Services trade data have a much longer lag time and are not readily available for many small U.S. trading partners, such as the Central American countries.

[22] This trend is not disputed, but the U.S. Department of Commerce does not disaggregate bilateral services trade data for the Central American countries. Estimates are provided in some of the Country Commercial Guides produced by Commerce based on foreign country reporting.

[23] United States International Trade Commission. Production-Sharing Update: (continued...)

Table 2. Top Eight U.S. Merchandise Imports from Central America, 2003

($ millions)

Product and HTS Number	Total	Costa Rica	Hon	Guat	El Sal	Nic
Total U.S. Imports	12,407	3,362	3,312	2,945	2,019	769
Knit Apparel (61)	4,737	309	1,887	1,076	1,318	147
Woven Apparel (62)	2,388	282	680	686	403	337
Edible Fruit & Nuts (08)	1,022	519	150	337	1	15
Bananas (0803)	(655)	(273)	(111)	(259)	(0)	(11)
Electrical Machinery (85)	975	814	98	2	34	39
Integrated circuits (8542)	(623)	(623)	(0)	(0)	(0)	(0)
Optical/Med. Equip. (90)	489	480	0	9	0	0
Spices, Coffee, Tea (09)	453	126	26	216	45	40
Coffee (0901)	(446)	(125)	(24)	(213)	(45)	(39)
Fish and Seafood (03)	293	69	124	21	19	70
Mineral Fuel, Oil (27)	181	4	0	177	6	0
Other	1,869	759	347	421	193	121
Top 8 Imports as % of Total	82.3	70.8	89.5	83.3	89.4	81.4

Data Source: U.S. Department of Commerce.
#HTS = Harmonized Tariff Schedule

Third, Costa Rica stands alone in having attracted $500 million in foreign direct investment to construct a computer chip assembly and testing plant, which has become its major export generator. This investment was augmented by an additional $110 million in October 2003 for the production line of "chipsets" for personal computers. In 2003, U.S. imports of integrated circuits grew by 39% on a dollar-value basis and constituted 18% of total imports from Costa Rica. Similar growth may be seen in imports of Costa Rica's medical equipment, another indicator of its relatively sophisticated production capabilities. Costa Rica is the fastest growing and most diversified trader in Central America, which explains, in part, why it has outpaced its neighbors on the development path and has been the leading advocate of CAFTA.[24]

Many non-apparel items that the United States imports from Central America face minimal or no tariffs. Bananas, coffee, oil, most fish products, and Costa Rica's integrated circuits and medical equipment enter duty free. Some enter the United States under preferential arrangements, but the majority is free of duty under normal (most favored nation — MFN) tariff rates. Apparel was technically excluded from preferential treatment under CBI, but under a special access program (SAP), eligible

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[23] (...continued)
Developments in 2001. *Industry Trade and Technology Review*. November 2003. pp. 13, 21-22, 28, B1-4.

[24] Hufbauer, Kotschwar, and Wilson, op. cit., p. 1003.

Central American apparel exports receive preferential treatment under production-sharing arrangements (Chapter 98 of the Harmonized Tariff System — HTS). This arrangement was extended under the Caribbean Basin Trade Partnership Act (CBTPA) in October 2000 (P.L. 106-200), which allows duty-free and quota-free treatment of apparel imports if assembled in the Central American countries from fabrics made in the United States made of U.S. yarns, whether the fabrics were cut to shape in the United States or Central America.[25]

U.S. Exports. The major U.S. exports to Central America include electrical machinery; apparel; plastic; yarns; and fabric (see **Table 3**). Many of these goods are processed in some form and re-exported back to the United States under production-sharing arrangements. For example, nearly 60% of electrical machinery exports to Central America is integrated circuits going to Costa Rica for processing and re-export. The same may be said for fabric and yarns that are exported to all five countries, sewn and otherwise assembled, and re-exported back to the United States. Some of these goods are consumed in the CAFTA countries along with capital goods (machinery and parts) and agricultural products.

Table 3. Top Eight U.S. Merchandise Exports to Central America, 2003

($ millions)

Product and HTS Number#	Total	Costa Rica	Hon	Guat	El Sal	Nic
Total U.S. Exports	10,859	3,414	2,845	2,274	1,824	503
Elec Machinery (85)	1,659	1,237	84	177	111	51
Integrated circuits (8542)	(999)	(997)	(0)	(1)	(1)	(0)
Knit Apparel (61)	821	103	423	36	252	8
Machinery (84)	993	307	224	220	195	48
Office Mach. Parts (8473)	(175)	(76)	(23)	(47)	(20)	(11)
Computer Parts (8471)	(139)	(48)	(13)	(33)	(35)	(9)
Knit/Crocheted Fabric (60)	663	34	340	16	266	8
Plastic (39)	574	256	81	147	79	11
Cotton Yarn (52)	570	13	307	165	74	11
Woven Apparel (62)	501	141	254	37	33	36
Cereals (10)	447	109	77	107	104	50
Corn (1005)	(196)	(57)	(29)	(54)	(47)	(8)
Wheat and Meslin (1001)	(162)	(34)	(27)	(44)	(39)	(18)
Rice (1006)	(87)	(17)	(20)	(9)	(17)	(23)
Other	4,631	1,214	1,055	1,369	710	280
Top 8 Exports as % of Total	57.4	64.4	63.0	40.0	61.1	44.3

Data Source: U.S. Department of Commerce.
#HTS = Harmonized Tariff Schedule

[25] For the technical details of this arrangement, see CRS Issue Brief IB95050, *Caribbean Basin Interim Trade Program: CBI/NAFTA Parity*, by Vladimir N. Pregelj.

The same distinctions seen in U.S. import trade are evident in U.S. exports. In 2003, 73% of knit and woven apparel and 80% of knit, cotton, and yarn fabric went to Honduras and El Salvador. These two countries are the heart of the maquiladora relationship. Although the United States exports machinery and parts to all five countries, electrical machinery and particularly integrated circuits, are sent to Costa Rica. All five countries import U.S. cereals and some, such as corn and rice, are among the more import sensitive products that the Central American countries would like to continue protecting.[26]

The significant aspects of this trade structure are that it reflects: 1) growing U.S. direct investment over the long run; 2) a deepening economic integration; and 3) the continued historical trend of regional dependence on the large U.S. market as an important aspect of trade and development policy.

U.S.-Dominican Republic Trade

The Dominican Republic is the 26th largest U.S. export market (5th in the Western Hemisphere) and ranks as the 38th largest import country (7th in the Western Hemisphere). More so than any of the Central American countries, Dominican trade is dominated by the United States (see **Table 4** for details). The United States absorbs 85% of its exports, with 10% going to other developed countries and only 5% entering developing countries. The Dominican Republic imports 49% of its merchandise goods from the United States, 17% from other developed economies, and 34% from various developing countries. Although the largest of the CAFTA trading partners, U.S. exports actually declined by nearly 1% in 2003 because of a severe economic downturn in the Dominican Republic.

Table 4. U.S.-Dominican Republic Merchandise Trade, 2003

U.S. Exports (by product and HTS Number*)	$ millions	U.S. Imports (by product and HTS Number*)	$ millions
Electrical Machinery (85)	431	Woven Apparel (62)	1,241
Oil (not crude) (27)	366	Knit Apparel (61)	858
Knit Apparel (61)	344	Medical Instruments (90)	450
Cotton Yarn, Fabric (52)	248	Electrical Machinery (85)	377
Plastic (39)	243	PreciousStones/Jewelry (71)	277
Woven Apparel (62)	235	Tobacco (24)	208
Machinery (84)	212	Footwear (64)	138
PreciousStones/Jewelry (71)	195	Plastic (39)	120
Other	1,940	Other	786
Total	4,214	Total	4,455
Top 8 Exports as % of Total	54%	Top 8 Imports as % of Total	82%

Data Source: U.S. Department of Commerce. #HTS = Harmonized Tariff Schedule

[26] USITC, Production-Sharing Update: Developments in 2001. *Industry Trade and Technology Review*. July 2002. pp. 39-42, B1-4

The joint-production arrangements of U.S.-Dominican trade are evident in apparel and jewelry-making industries, as seen in **Table 4**. Apparel and textiles constitute 20% of U.S. exports and 50% of U.S. imports. Other significant U.S. exports include various types of machinery, refined oil products, and plastic. Other important U.S. imports include medical instruments, electrical machinery, tobacco, and plastic. In many ways, the structure of the U.S.-Dominican trade is similar to that of U.S.-CAFTA trade, and hence the economic logic of "docking" it to the Central American agreement.

U.S. Foreign Direct Investment

The CAFTA countries also benefit from foreign direct investment (FDI) as part of the trade relationship with the United States, which is the largest foreign investor in all six countries. To the extent that an FTA can be considered a stabilizing factor in economic relationships, it is expected to encourage more FDI and thereby promote longer term economic growth and development. U.S. FDI in the CAFTA countries is presented in **Table 5**. The trends suggest that U.S. direct investment in the area is relatively small and has grown erratically in recent years. Investment patterns have also been skewed toward Costa Rica, which has over half of U.S. FDI in Central America.

Table 5. U.S. Foreign Direct Investment (FDI) in CAFTA Countries
($ millions)

Country	1999	2000	2001	2002
Costa Rica	1,493	1,716	1,677	1,602
El Salvador	621	540	361	580
Guatemala	478	835	389	391
Honduras	347	399	242	184
Nicaragua	119	140	157	242
Total Central America	3,058	3,630	2,826	2,999
Dominican Republic	968	1,143	1,233	1,123
Total CAFTA	4,026	4,773	4,059	4,122

Data Source: U.S. Department of Commerce. Bureau of Economic Analysis. Available at the website at [http://www.bea.doc.gov/bea/di/usdlongcty.htm].
Data reflect stock of FDI presented on a historical-cost basis.

Status of Trade Negotiations and Policy Issues

All CAFTA-related negotiations were finally concluded on March 15, 2004, at which time all five Central American countries, and separately the Dominican Republic, had agreed to two FTAs that will be joined. President George W. Bush formally notified Congress of his intention to sign CAFTA on February 20 and the FTA with the Dominican Republic on March 24, 2004. USTR Robert B. Zoellick and the five Central American trade ministers signed CAFTA on May 28, 2004, but

action still awaits on the U.S.-Dominican FTA. The Bush Administration does not anticipate sending implementing legislation to Congress until after the November 2004 elections. The CAFTA negotiations were ground-breaking in trying to navigate the needs of five (and eventually six) different U.S. trading partners within a "bilateral framework." The unusual nature of the process was reflected in the three months that elapsed from the time the agreement was agreed to by four Central American countries and when Costa Rica and the Dominican Republic acceded.

CAFTA was negotiated, in part, as a regional agreement in which all parties would be subject to the "the same set of obligations and commitments," but with each country defining its own separate schedules for market access on a bilateral basis. The flexibility of this framework allowed Costa Rica to negotiate longer, and for a slightly different arrangement than the other four Central American countries, each of which also negotiated separate market access schedules. It is also what will allow the Dominican Republic to be added at a later date.

Costa Rica's delay centered on resolving details over how it would open its state-run insurance and telecommunications industries, and the treatment of certain sensitive agricultural products. In addition, it wanted special duty-free treatment extended to apparel products made from materials outside the region, arguing that because it has higher labor costs and standards, it should be allowed to deviate from rules requiring the use of higher-cost U.S. materials. Costa Rica faces a serious political challenge to opening its services industries and argued that a rebalancing of the agreement in other areas was a necessary quid pro quo for CAFTA to be accepted by its Congress. A compromise was struck eventually.[27]

The Dominican Republic was another matter. The United States originally negotiated CAFTA with just the five Central American republics in mind. In fact, the Central American countries first approached the United States separately as a group because they already had a common market and a history of negotiating trade agreements collectively. The Dominican Republic, however, has a similar economy, an FTA with Central America, and solid political constituency in the United States, making it a natural fit with CAFTA. So from the beginning, the U.S.-Dominican agreement was negotiated with an eye on integrating it with CAFTA.

The USTR released CAFTA and U.S.-Dominican FTA draft texts on January 28, 2004 and April 9, 2004, respectively, which are the basis for the following discussion. Both have undergone final revisions for legal clarity and accuracy. A summary of the issues follows, organized topically by the five working groups and capacity building.[28] CAFTA is a comprehensive and reciprocal trade agreement,

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[27] This summary is based on news accounts and discussions with representatives of the Costa Rican government. See Government of Costa Rica. Ministry of Foreign Trade. *Press Release: Central America — U.S. Free Trade Negotiations*. December 18, 2003.

[28] Bowing to Central America's limited resources and desire to consolidate negotiations, the United States agreed to establish only five working groups responsible for: 1) market access (including agriculture); 2) investment and services; 3) government procurement and intellectual property; 4) labor and environment; and 5) dispute settlement and other (continued...)

which distinguishes it from the CBI unilateral preferential arrangement between the United States and these countries. In addition to detailed rules governing market access, CAFTA potentially opens up opportunities for highly competitive U.S. sectors by addressing services, government procurement, intellectual property, and investment.

Market Access

The market access working group focused on key issues determining the tariff structures and rules that would govern the movement of commercial, industrial, and agricultural goods. Chapter 3, Market Access for Goods, and Chapter 4, Rules of Origin, define most of these rules. Market access covers provisions that eliminate or reduce barriers to trade such as tariffs, quotas, and safeguards. Rules of origin detail which goods would be eligible for preferential treatment based on their regional content, with the intent of preventing transshipment of goods from countries outside the agreement. With the exception of safeguard language allowing for the imposition of additional duties if imports cause or threaten to cause serious injury to a domestic industry, trade remedy issues (antidumping and countervailing duties) are not addressed in CAFTA.

The CAFTA countries had two important goals. First, consolidate access to the U.S. market, which meant clarifying, making permanent, and improving on preferential tariff treatment currently applied to many of their major exports under the CBI and the Generalized System of Preferences (GSP). Second, specify rules for safeguards and tariff rate quotas (TRQs) to assure domestic producers of recourse should there be a spike in imports of sensitive goods from the United States (e.g. beef, pork, corn, and rice). For the United States, CAFTA would change the trade arrangement with Central America from one based on unilateral trade preferences to a bilateral FTA. The United States sought equal or better treatment than what other countries receive (especially Canada and Mexico) under their FTAs with Central America, including obtaining access for sensitive agricultural products. In addition, it had to address sensitive product issues as well, such as sugar and apparel. These goals are set out in detailed schedules for each country.

Annex 3.3 of CAFTA defines the tariff elimination "staging categories." Each traded good falls into one of eight different categories labeled A through H, which defines the time period over which duties will be eliminated. Many goods would attain immediate duty-free treatment, while others would have tariffs phased out incrementally so that duty-free treatment is reached in 5, 10, 15, or 20 years from the time the agreement takes effect. Duty-free treatment would be delayed for the more sensitive products, and in some cases, the tariff reductions would not begin until 7 or 12 years into the agreement.

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[28] (...continued)
institutional issues. In addition, there is a non-negotiating multi-agency effort responsible for supporting trade capacity building (TCB). By contrast, the U.S.-Chile negotiations used 17 working groups and the FTAA negotiations utilize nine, plus three non-negotiating support groups.

According to the USTR, if CAFTA enters into force, 81% of non-agricultural and non-textile exports would become duty-free immediately, with all tariffs removed within 10 years (covering staging categories A, B, and C). Tariffs would go to zero immediately on many product categories including information technology products, agricultural and construction equipment, paper products, chemicals, and medical/scientific equipment. For the Central American countries, benefits received under the CBI would become permanent, allowing 100% of non-agricultural and non-textile goods to enter the United States duty free immediately.[29]

Agriculture and apparel goods, Central America's major exports, were the most difficult market access issues to resolve.[30] Domestic support programs were not addressed in CAFTA, but major strides were made to reduce tariffs, the major trade-distorting policy, and also to provide generous transition schedules to all countries with sensitive agricultural products. Agricultural products have the most generous tariff phase-out schedules, with up to 20 years for some products (e.g. rice and dairy). This approach acknowledges that countries dependent on small subsistence farms require time to accommodate the structural adjustment taking place as their economies transition toward larger farms, manufacturing, and services.[31] All agricultural goods would eventually become duty-free except for sugar in the United States, fresh potatoes and onions in Costa Rica, and white corn for the other Central American countries. Over half of current U.S. farm exports to Central America would become duty free immediately, including high quality cuts of beef, cotton, wheat, soybeans, certain fruits, and vegetables, processed food products, and wine. At the same time, the U.S. conceded to slight increases in sugar quotas for all six countries, which remains a controversial provision.[32]

Many agricultural products would be subject to tariff-rate quotas, or limits on the quantity of imports that can enter the United States before a higher tariff is applied. The phased reduction in agriculture protection also includes the transitional use of price and volume-triggered safeguards, or applying temporarily an additional duty on products that are being imported in quantities deemed a threat to the domestic industry.[33] Export subsidies would be eliminated except when responding

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[29] Office of United States Trade Representative. *Free Trade with Central America: Summary of the U.S.-Central America Free Trade Agreement*. p. 1. Hereafter cited as the *CAFTA Summary*. It may be found at [http://www.ustr.gov].

[30] For more details, including sanitary and phytosantiary (SPS) provisions, see CRS Report RL32110, *Agricultural Trade in a U.S.-Central American Free Trade Agreement (CAFTA)*, by Remy Jurenas.

[31] Salazar-Xirinachs, Jose M. and Jaime Granados. *The United States-Central America Free Trade Agreement: Opportunities and Challenges*. Paper prepared for the Institute for International Economics Conference on "Free Trade Agreements and U.S. Trade Policy, May 7-8, 2003. Washington, D.C. p. 19

[32] U.S. Sugar Industry Group. *Press Release: Mexican and US Sugar Industries Jointly Oppose CAFTA Sugar Provisions*. December 18, 2003.

[33] For example, in the case of beef, the Central American countries have agreed to the immediate elimination of tariffs on U.S. prime and choice cuts, but have a 15-year tariff (continued...)

to third party export subsidies. The United States would be able to impose a sugar price mechanism to compensate sugar exports in lieu of according duty-free treatment.

Apparel trade was the other major market access complication, with differing opinions on CAFTA emanating from different subgroups. In general, apparel representatives are on record as supporting CAFTA, whereas there is some disagreement among the textile producers in the United States over whether CAFTA would enhance the existing strategic partnership. Differences arose over detailed elements of the agreement rather than the overall design, which is based on reciprocity, flexibility, and transparency. Also, most supported the provision that would make the textile portions retroactive to January 1, 2004 because it would be "a powerful incentive to anchor apparel sourcing in the region in preparation for the January 1, 2005 phase out of quotas," which will increase competitive pressure from China and other Asian apparel sources.[34]

Central American and Dominican apparel has been entering the United States duty free for years provided it is assembled from U.S. materials under the so-called "yarn forward" rule. This rule was widely supported as defined in CAFTA, but some textile producers registered concern that it is overly restrictive. The CAFTA countries wanted as much flexibility as possible to use fabrics from third countries. Under the cumulation rule, CAFTA would allow duty-free treatment to be extended selectively, and on a limited basis, to CAFTA products made from NAFTA-partner materials, a new step toward integrating apparel manufacturing in the region. Duty-free treatment would also be extended to goods with limited amounts of material from third countries, which also engendered disagreement. There was also considerable debate over the expanded "short-supply" list (Annex 3.25), or duty-free access given to goods made from a specific list of fabrics that are determined to be in "short supply" in the United States. In addition, Nicaragua, because of its lagged development relative to the rest of the region, would receive special trade preference levels (TPLs), criticized by some textile groups, that would allow additional duty-free treatment for specified articles.[35]

Investment and Services

In 2002, the United States' stock of foreign direct investment (FDI) in the CAFTA countries was $4.1 billion, which represents only 1.5% of U.S. FDI in Latin

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[33] (...continued)
phase-out on other products, with a backloaded schedule (no tariff reductions in the early years) and a safeguard. The United States has a 26% out-of-quota tariff on beef that will be phased out over 15 years, with the quota schedule defined for each country.

[34] USTR. *Report of the Industry Sector Advisory Committee on Textiles and Apparel*. March 2004.

[35] Inside U.S. Trade. *CAFTA Textile Rules Pave Way for Increase in Foreign Fabric Use.* December 19, 2003 and Press Release. *NTA Denounces CAFTA as Threat to U.S. Textile Industry*. December 18, 2003 and USTR, CAFTA Summary, p. 2. Nicaragua received special preferential treatment for certain "non-originating apparel goods"(Annex 3.27) and Costa Rica received limited special treatment for certain wool apparel goods (Annex 3.28).

America and the Caribbean. Nearly 40% of the FDI in CAFTA countries went to Costa Rica. The United States has advocated clear and enforceable rules for foreign investment in all trade agreements, which is largely accomplished by "standard" language requiring national and most-favored-nation (nondiscriminatory) treatment. CAFTA would clarify rules on expropriation and compensation, investor-state dispute settlement, and the expedient free flow of payments and transfers related to investments, with certain exceptions in cases subject to legal proceedings (e.g. bankruptcy, insolvency, criminal activity). Transparent and impartial dispute settlement procedures would provide recourse to investors.

Two investment issues stand out. First, the CAFTA countries requested greater flexibility in the treatment of certain sovereign debt. Annex 10-A allows sovereign debt owed to the United States that has been suspended and rescheduled not to be held subject to the dispute settlement provisions in investment chapter, with the exception that it be given national and MFN treatment. Annex 10-E extends from six months to one year the amount of time required before a U.S. investor may seek arbitration related to sovereign debt with a maturity of less than one year. Both provisions are intended, in the event of a financial crisis, to keep CAFTA from interfering in any sovereign debt restructuring process, and are viewed by the U.S. Treasury as an accommodation to Central American interests.

A second issue involves provisions covering indirect expropriation, which protects foreign-owned property from government regulation and other action that may have a negative effect "tantamount to expropriating the property." Claims made under NAFTA against U.S. environmental laws is one prominent example. The TPA provisions called for a tightening of these provisions to make such claims harder to pursue in accordance to U.S. legal standards, which was effectively accomplished in both the U.S.-Chile FTA and CAFTA.[36] Some parties have argued against any recourse to indirect expropriation, believing that it impinges on a government's ability to regulate, despite it being a well-established principle. Other groups have disagreed over its application.

Services trade presented a number of hurdles given that the Central American countries have adopted few commitments of the WTO's General Agreement on Trade in Services (GATS). There are also many industry-specific barriers that exist, such as: barriers to foreign insurance companies in Guatemala; "heavy" regulation licensing of foreign professionals in Honduras; local partner requirements in some financial services in Nicaragua; and numerous services monopolies in Costa Rica (insurance and telecommunications).[37] CAFTA would provide broad market access for most industries including telecommunications, financial services, distribution services, computer and business technology services, tourism, and many others. Banks and insurance firms would have full rights to establish subsidiaries, joint

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[36] For details, including how the provisions evolved from NAFTA to the U.S.-Chile FTA, see CRS Report RL31638, *Foreign Investor Protection Under NAFTA Chapter 11*, by Robert Meltz. pp. 11-14.

[37] USTR. *2003 National Trade Estimate Report on Foreign Trade Barriers.*

ventures, and branches. Regulation of service industries is required to be transparent and applied on an equal basis.[38]

Costa Rica and the United States agreed to negotiate bilaterally on a number of key issues considered unique to Costa Rica. One of them was the language covering opening of state-run telecommunications and insurance industries, where there has been strong political resistence to deregulation.[39] Unlike the other countries, doing so would constitute a major structural adjustment for the Costa Rican economy, have implications for Costa Rican social policy, and require amending the constitution, all of which, the Costa Ricans argued, would be difficult for their legislature to support without concrete tradeoffs in other areas, such as agriculture and textiles. These issues were resolved in two week-long discussions held in January 2004 and their detailed commitments are presented in the relevant chapters of CAFTA.

Government Procurement and Intellectual Property Rights

These two areas were also of particular interest to the United States. CAFTA was seen as an opportunity to remedy many deficiencies and move toward strong enforcement of standardized practice in the region. None of the five Central American countries is a signatory to the WTO Agreement on Government Procurement and allegations against the various purchasing processes vary from dissatisfaction with less than transparent and cumbersome procedures in Costa Rica to outright corruption in Guatemala. El Salvador and Nicaragua passed new government procurement laws in 2000 and Honduras followed in 2001, and in general, there have been improvements in all countries in dealing with project bidding, although transparency issues remain.[40] In part, this is due to a lack of incentives given that many of these countries would not be able to compete in the U.S. government procurement market.[41]

CAFTA would grant non-discriminatory rights to bid on contracts from Central American ministries, agencies, and departments, with the exception of "low-value contracts" and other exceptions. It would also call for procurement procedures to be transparent and fair, including clear advance notices of purchases and effective review. Specific schedules detailing exceptions and limitations were written by each country, covering such diverse issues as the sale of firearms to supplying school lunch programs. CAFTA would also make clear that bribery is a criminal offense under the laws of all countries.[42]

All Central American countries are revising, or have revised, their intellectual property rights (IPR) laws and some are closing in on complying with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). That

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[38] USTR, *CAFTA Summary*, p. 2-3.

[39] Salazar-Xirinachs and Granados, op.cit., p. 22-23.

[40] USTR, *2003 National Trade Estimate Report on Foreign Trade Barriers*.

[41] Salazar-Xirinachs and Granados, op.cit., p. 25-26.

[42] USTR, *CAFTA Summary*, p. 5.

said, all countries are subject to criticism for falling short on either clarifying or enforcing penalties for noncompliance and in some cases have simply not adopted reforms that many U.S. industries (e.g., sound and video recordings, pharmaceuticals, book publishing, computer software) consider necessary to protect their intellectual property. Piracy, incomplete or inadequate legal protection, and enforcement capacity remain problems and ongoing concerns exist across the range of IPR issues of patents, trademarks, and copyrights, covering print, electronic, and other media.[43]

The IPR provisions in CAFTA would provide that U.S. and Central American businesses receive equal treatment in all areas and that the CAFTA countries ratify or accede to various international IP agreements. Trademarks would benefit from a transparent on-line registration process and special system to resolve disputes over internet domain issues, among other benefits. Copyright provisions would clarify use of digital materials including rights over temporary copies of works on computers (music, videos, software, text), sole author rights for making their work available on-line, extended terms of protection for copyrighted materials, strong anti-circumvention provisions to prohibit tampering with technologies, the requirement that governments use only legitimate computer software, the prohibition of unauthorized receipt or distribution of encrypted satellite signals, and rules for liability of internet service providers for copyright infringement. Patents and trade secrets rules would conform more closely with U.S. norms. End-user piracy would be criminalized and all parties would be required to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods. CAFTA would also mandate statutory damages for copyrighted material.[44]

For many countries, these commitments require significant changes in law, which may prove politically challenging in countries where there is no tradition of strong IPR protection. In general, there is a concern that strict IPR provisions may impede technology transfer to the CAFTA countries. Pharmaceutical products is one high profile case, pitting the social concern for making drugs available at an "appropriate price" (branded versus generic) against the needs of the industry to recover the high costs of research and navigating the regulatory process. Rules governing the protection of firm and industry research data has also inflamed the debate of pharmaceuticals. These issues, and more basic concerns over piracy, present huge legislative and enforcement challenges.

Labor and Environment

Perhaps the greatest challenge to CAFTA arises from the environment and labor chapters, which complicate the trade negotiation process by moving it beyond purely commercial issues into the realm of social policy. Although it has become widely accepted that social issues can be affected by trade liberalization, there is considerable disagreement over how aggressive language in trade agreements should be in accommodating this concern. Should trade agreements require all countries to meet specific core standards, or is this approach too stringent? Is a trade agreement

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[43] Ibid.

[44] Ibid., p. 4-5.

the best, or even a good enforcement mechanism for social policy that usually is the purview of domestic laws and regulation?

From an economic perspective, labor and environment advocates in the United States argue that developing countries may have an "unfair" competitive advantage because their lower standards are the basis for their lower costs, which in turn are reflected in lower prices for goods that compete with those produced in developed countries.[45] It follows from this argument that the difference in costs is an enticement to move U.S. investment and jobs abroad. On the other hand, studies also suggest that these cost differentials are usually not high enough to determine business location alone, and that productivity remains the primary decision factor.[46] Further, many economists view trade liberalization as part of the overall development process that, in and off itself, can promote social change.[47] Developing countries are also concerned with sovereignty issues related to specifying standards in trade agreements and the possibility that such provisions can be misused as a disguised form of protectionism.

Environmental Issues. For environmental advocates, major goals include protecting and assuring strong enforcement of existing domestic environmental standards, ensuring that multilateral environmental agreements are not undermined by trade rules, promoting strong environmental initiatives to evaluate and raise environmental performance, developing a systematic program of capacity-building assistance, and assuring that environmental provisions in FTAs are subject to the same dispute resolution and enforcement mechanisms as are other aspects of the agreements.[48]

The USTR summary states that congressional objectives on environmental issues have been met in the proposed CAFTA agreement. It includes language requiring all countries to enforce their laws and regulations and also creates an

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[45] The difference is that the social costs associated with environmental degradation, pollution, poor working conditions, and low wages are not captured in the production process. Through legal and regulatory measures, developed countries require that businesses bear many of these costs, which are then reflected in the final (relatively higher) price of the good or service in the market place.

[46] See CRS Report 98-742 E, *Trade with Developing Countries: Effects on U.S. Workers*, by J.F. Hornbeck. September 2, 1998, pp 11-13. Productivity and wage levels are, however, highly correlated. See Rodrik, *Sense and Nonsense in the Globalization Debate*, pp. 30-33.

[47] In addition to the specifics of CAFTA addressed in this section, it is interesting to note that there is some broader evidence that FTAs have not "forced a race to the bottom of regulatory standards," but rather to the contrary, that policy convergence is affected more by countries agreeing to "norms of governance" via cooperation through international agreements. See Drezner, Daniel W. Globalization and Policy Convergence. *International Studies Review*. Vol. 3, Issue 1, Spring 2001. pp. 75 and 78.

[48] See [http://www.sierraclub.org/trade/fasttrack/letter.asp], *Principles for Environmentally Responsible Trade.* Another important issue for the United States is ensuring that its higher environmental standards defined in law and regulation not be compromised by challenges of protectionism. See CRS Report RS20904, *International Investor Protection: "Indirect Expropriation" Claims Under NAFTA Chapter 11*, by Robert Meltz.

environmental cooperation agreement with a framework for establishing a cooperation commission and a process to conduct capacity building. All parties would agree to commit to establish high levels of environmental protection, and open proceedings in the administration and enforcement of laws and regulations.[49]

The environmental provisions are not the most contentious issues in CAFTA. Advocates still raise the issue of the environmental effects of trade, particularly in developing countries that may have lax laws and enforcement mechanisms. Many of these same advocates, however, have conceded that trade agreements have not led to catastrophic pollution problems nor encouraged a "regulatory race to the bottom." There has also been a certain acknowledged degree of success in having environmental issues addressed in the body of FTAs, in side agreements on environmental cooperation, and through technical assistance programs, the latter of which developing countries can use to respond to specific problems. Advocates still note that much can be improved, such as tightening enforcement language and ensuring that the United States allocates financial resources to back up promises of technical assistance, particularly in the case of Central America, where commitment to "public accountabilty" is questioned in some cases.[50]

The Trade and Environment Policy Advisory Committee supports most of the environment provisions in CAFTA and particularly the enhanced public participation process negotiated by the State Department in a environmental cooperation side agreement. The dispute settlement provisions, which are effectively the same rules governing labor disputes, were accepted as striking the "proper balance." The advisory committee still raised a number of specific environmental concerns, and questioned whether CAFTA would be able to meet congressional objectives on capacity building without concrete funding for the program.[51]

Labor Issues, Congress, and TPA. Arguably, the most contentious issue of CAFTA, and identical to the debate waged over the U.S.-Chile FTA, is the extent to which various parties are satisfied with the labor provisions. The USTR, in its summary of the CAFTA labor provisions, makes three important claims with respect to the agreement, that it:

- fully meets the labor objectives set out by Congress in the Trade Promotion Act of 2002 and makes labor obligations a part of the core text of the trade agreement;
- includes unprecedented provisions that commit CAFTA countries to provide workers with improved access to procedures that protect their rights;

[49] For more details on congressional interest in environmental provisions in trade agreements, see CRS Report RS21326, *Trade Promotion Authority: Environment Related Provisions in P.L. 107-210*, by Mary Tiemann.

[50] See Audley, John. *Environment and Trade: The Linchpin to Successful CAFTA Negotiations?* Carnegie Endowment for International Peace. Washington, D.C. July 2003.

[51] Trade and Environment Policy Advisory Committee on the Central American Free Trade Agreement. *The U.S.-Central American Free Trade Agreement*. March 12, 2004.

- goes beyond Chile and Singapore FTAs through a 3-part cooperative approach to improve working conditions by: 1) ensuring effective enforcement of existing labor laws; 2) working with the ILO to improve existing labor laws and enforcement; and 3) building local capacity to improve workers rights.

U.S. labor advocates charge to the contrary, that "The labor provisions of CAFTA will not protect the core rights of workers in any of the six countries participating in the agreement."[52] The crux of the critique within CAFTA centers on the dispute settlement provisions and the extent to which they are effective in requiring countries to meet certain standards, and also to meet congressional trade negotiating objectives defined in TPA. Labor advocates argue that they are a step backward from the provisions allowing for the suspension of trade benefits found in the GSP and CBI, which currently govern much of the U.S. trade with Latin America. Specifically, there are three provisions given different weight in CAFTA: 1) the effective enforcement of domestic labor laws, 2) the reaffirmation of commitments to ILO basic principles, and 3) "non-derogation" from domestic standards (not weakening or reducing protections to encourage trade and investment).[53]

Failure to enforce domestic labor laws can be formally challenged in the dispute resolution process as defined in CAFTA. In the case of the other two provisions, which are supported in principle, such recourse is not available (Articles 16.2 and 16.6). The USTR points to cooperative mechanisms for improving workers' rights in the FTA, but labor advocates argue that unless all three are enforceable, CAFTA does not provide a meaningful trade discipline, especially in Central America, where lax enforcement of labor rights has been documented in many cases.[54]

In addition, for labor (and environment) issues, the dispute resolution process operates differently than for commercial issues. If a commercial dispute remains unsettled, the country faces the possibility of suspension of benefits under the FTA "of equivalent effect" (Article 20.16), resulting in the raising of tariffs, or payment of a monetary assessment equal to 50% of what a dispute panel determines is "of equivalent effect." This article does not apply to the disputable labor provision. The difference is that the option for failing to resolve a labor dispute is a monetary assessment, which would be capped at $15 million per year, with recourse to an equivalent dollar value of suspended benefits (higher tariffs) if the monetary assessment is not paid. The monetary assessment would also be paid into a fund and expended for "appropriate labor initiatives." Labor advocates argue that by capping the assessment at $15 million and having the assessment paid into a fund in the offending country, the labor provisions are rendered ineffective. The USTR argues

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[52] Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC). *The U.S.-Central America Free Trade Agreement*. March 19, 2004. p. 1.

[53] Ibid, p. 6 and Lee, Thea M. Assistant Director for International Economics, AFL-CIO. *Comments on the Proposed U.S.-Central American Free Trade Agreement*, before the USTR Trade Policy Committee, November 19, 2002.

[54] For the Department of State reports on human rights, including labor rights, see [http://www.state.gov/g/drl/rls/hrrpt/2003].

that for a small countries, such a fine would be significant relative to the dollar value of the trade benefits it would receive.[55]

From a congressional perspective, there is the question of whether differences in the treatment of the three labor provisions in some way fail to meet the principal negotiating objectives as outlined in TPA legislation. Although the three provisions are not accorded the exact same treatment in CAFTA, neither are they in the TPA language. Section 2102(b)(11) of the Trade Act of 2002 (TPA) states that among the principal labor negotiation objectives is the provision "*to ensure that a party* to a trade agreement with the United States *does not fail to effectively enforce* the environmental or *labor laws*." This may be contrasted with the apparently weaker objective "*to strengthen the capacity* of United States trading partners *to promote respect for core labor standards,*" and, in Sec. 2102(a)(1)(7) to "*strive to ensure* that *they do not weaken or reduce the protections afforded in* domestic environmental and *labor laws* as an encouragement for trade."

Although the TPA provisions seem to differ with respect to treatment of these three labor provisions, under the dispute resolution provision (sec. 2102(b)(12)(G)), a principal negotiating objective also listed is "to seek provisions that treat United States principal negotiating objectives equally" with respect to the ability to resort to dispute settlement, the availability of equivalent procedures, and the availability of equivalent remedies. Whereas the labor groups have argued that this is not the case with labor and commercial disputes, the USTR has responded that this standard has been met since both commercial and labor disputes are subject to monetary assessments and suspension of benefits. The dispute settlement procedures do operate slightly differently, however, and it may be a matter of interpretation as to whether there is a problem in their meeting congressional negotiating objectives.[56]

Unlike environmental advocates, labor groups have not agreed that a proper balance has been struck within CAFTA. These same criticisms were made of the U.S.-Chile FTA one year earlier and labor advocates have not supported CAFTA as negotiated. Practical issues have also been raised. For example, support for core labor rights is one thing, but actually monitoring them, identifying violations, and resolving disputes in a uniform way would create immense measurement and interpretive challenges for dispute arbitration panels. This raises two thorny questions, the first being, could the United States be challenged over failure of its labor practices to conform to all ILO core labor standards? The second question addresses equity in practice. Would all countries be subject to the same standards irrespective of economic size and strategic importance?[57]

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[55] Lee, op. cit., and Labor Advisory Committee Report.

[56] It should also be noted that under the principal negotiating objectives with respect to labor is the provision: 1) "to recognize that parties to a trade agreement retain the right to exercise discretion" in investigating and prosecuting compliance matters; 2) that "a country is effectively enforcing its laws" if its reflects reasonable action as being taken; and 3) "no retaliation may be authorized based on the exercise of these rights or the right to establish domestic labor standards." Sec. 2102(b)(11)(B).

[57] These issues were explored in a report prepared by the National Academy of Sciences. (continued...)

Finally, whether CAFTA labor provisions conform to the negotiating objectives of Congress is another matter. It is possible that CAFTA may be construed as meeting the strict guidelines set out in TPA, but still fail to meet the standards of many Members of Congress.

Dispute Resolution and Institutional Issues

This negotiation group focused on numerous aspects that define how the trade agreement will operate, particularly with respect to rules governing procedures for dispute resolution. Dispute resolution is modeled on previous FTAs, in which disagreements are intended to be resolved cooperatively, first via a consultative process. If this approach is not successful, the process moves to the establishment of the Free Trade Commission of cabinet-level representatives, and finally an arbitral panel. Arbitral panels are intended to broker mutually acceptable resolutions, including providing for compensation if appropriate. If a mutually agreed solution is not found, the complaining party may resort to a suspension of benefits of equivalent effect. This may also be challenged and final resolution and how the suspension of benefits are to be administered are set out in guidelines. Resolving labor and environmental disputes would be slightly different (see previous section). All dispute resolution procedures are defined in Chapter 20. Administrative and other technical matters (e.g. transparency issues) of trade agreement implementation were also addressed by this working group.

Trade Capacity Building

Even before detailed discussions began on CAFTA, the Central American countries expressed a strong apprehension of being overwhelmed by the resources and experience that the United States could muster to negotiate and later comply with liberalized trade rules. Hence, the need for trade capacity building, which, now that the negotiation process is over, may be classified into three distinct areas beyond trade negotiation capabilities. First, the ability to identify priorities, including where the major adjustment costs (losers) are expected to be and how to respond to them. Second, the ability to develop resources to implement the agreement, including institutional, financial, and analytical resources. Third, the capacity to benefit from CAFTA.[58] CAFTA would create a permanent Committee on Trade Capacity Building to continue work begun in the negotiation process, and recommendations in the agreement call for one of its first priorities to be customs administration.

The third category, however, is arguably the most challenging. Also referred to as "supply side" capacity, it refers to the ability of a business to: compete in a larger market; learn how to export and use imports (as inputs) more to its advantage; tap into global finance; navigate customs and trade logistics problems; and in other ways

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[57] (...continued)
A summary of the key issues is provided in: Moran, Theodore H. *Trade Agreements and Labor Standards*. The Brookings Institution. Policy Brief #133. May 2004.

[58] This typology of capacity issues was developed by Bernard Hoekman of the World Bank. Earlier versions of this report mentioned a fourth area, trade negotiation capacity.

make the transition from local producer to international player.[59] This will be a difficult challenge for many Central American firms, particularly if barriers to world trade are reduced outside the U.S.-Central American relationship (WTO/FTAA) putting increasing pressure on marginally productive businesses. The joint-production relationship already established in textiles and garments suggests that certain firms have already developed some expertise in meeting these challenges.

From the outset of negotiations, the United States advocated assisting the Central American countries. Each Central American country prepared a National Action Plan based on a review of its "trade-related" needs. Assistance is being provided by the United States, private groups (corporate and non-government organizations — NGOs), and five international organizations (the Inter-American Development Bank — IDB, Central American Bank for Economic Integration — CABEI, United Nations Economic Commission on Latin America and the Caribbean — ECLAC, Organization of American States — OAS, and the World Bank).[60] In the view of many, what is lacking is an adequate commitment for financial and institutional support in the years to come.

Outlook

The CAFTA negotiations moved quickly and were concluded by the anticipated year-end 2003 deadline, with the exception of a slight delay with Costa Rica and the addition of the Dominican Republic. A final version of the agreement was signed on May 28, 2004, but it appears as though implementing legislation will not be sent to Congress until after the November 2004 elections, in large part because of disagreement over politically sensitive labor provisions.

CAFTA was ambitious and innovative in melding the interests of the United States with those of five (later six) smaller countries that vary significantly among themselves. CAFTA would build on long-established trade partnerships, but would also change the framework from a unilateral preferential arrangement defined under the CBI program, as amended, to a negotiated bilateral agreement. These altered terms would provide the United States with greater access for vital sectors of its economy, but have also allowed the Central American countries greater say in how controversial provisions, such as labor rights enforcement, would work. In the end, supporters hope that CAFTA can be part of a policy foundation supportive of both improved intra-regional trade and long-term social, political, and economic development.[61]

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[59] Ibid.

[60] Details of the program and the Central American National Action Plans may be found at the USTR website: [http://www.ustr.gov].

[61] Reducing rich-country protectionism is a critical goal set out by a study aimed at highlighting policies that may effect social development and equity in Latin America. See Birdsall, Nancy, Augusto de la Torre, and Rachel Menezes. *Washington Contentious: Economic Policies for Social Equity in Latin America*. Carnegie Endowment for (continued...)

CAFTA, however, is controversial and faces political uncertainty. In addition to concerns over increased competition by specific sectors of the U.S. economy (sugar, textiles), detractors argue that a balanced outcome may be difficult to achieve if CAFTA also fails to accommodate sufficiently the adjustment costs facing certain Central American workers, small farmers, and other groups, despite efforts to phase in the agreement's tariff schedules and rules over time. Some countries may find it difficult to benefit fully given their level of development, an issue that arose during the early years of the Central American Common Market. Another key concern is the history some CAFTA countries have of poor labor rights enforcement, raising questions of whether CAFTA labor provisions will adequately promote social development. The potential for negative sectoral employment effects in the United States also factors into critiques of CAFTA.

As indicated at the outset of this report, CAFTA presents challenges to policymakers on multiple levels. First, there are very specific short-run economic tradeoffs associated with any trade agreement, irrespective of long-run welfare gains expected for all countries. Second, a trade agreement is only one aspect of broader strategic considerations (political/security concerns) for the region. Third, whatever decision is taken on CAFTA, it will likely have a far reaching effect on how (or even if) future trade negotiations will proceed with Latin America and perhaps other areas of the world. To complicate matters further, policymakers face competing goals and constituencies both within and among these different levels of policy consideration.

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[61] (...continued)
International Peace and Inter-American Dialogue. Washington, D.C. 2001. pp. 65-66.

Appendix 1. Chronology of CAFTA Negotiations

Date	Milestone
January 16, 2002	President George W. Bush announces his intention to explore a free trade agreement (FTA) with Central America.
August 6, 2002	President Bush signs the Trade Act of 2002 (P.L.107-210), which includes Trade Promotion Authority (TPA).
October 1, 2002	President Bush, as required under TPA, formally notifies Congress of his intention to negotiate a U.S.-Central America Free Trade Agreement (CAFTA) with Guatemala, El Salvador, Honduras, Costa Rica, and Nicaragua.
November 19, 2002	USTR holds public hearings, accepting written and oral testimony on CAFTA.
January 27, 2003	The first of nine negotiation rounds begins in San Jose, Costa Rica.
December 17, 2003	CAFTA negotiations concluded in Washington, D.C. Costa Rica decides not to accept the agreement pending further discussion on telecommunications, insurance, agriculture, and textile market access issues.
January 5-9, 2004	Costa Rica and the United States hold first round of bilateral discussions on CAFTA.
January 12-16, 2004	First round of negotiations with Dominican Republic held.
January 19-24, 2004	Costa Rica and United States hold second round of bilateral discussions on CAFTA.
January 25, 2004	Costa Rica and United States agree to CAFTA provisions.
January 28, 2004	USTR releases draft version of CAFTA to public.
February 20, 2004	President Bush formally notifies Congress of his intention to sign CAFTA.
March 15, 2004	The United States and the Dominican Republic conclude a bilateral FTA and the USTR announces it will be "docked" to CAFTA.
March 24, 2004	President Bush formally notifies Congress of his intention to sign the U.S.-Dominican Republic FTA.
May 28, 2004	The USTR and trade ministers from the Central American countries sign CAFTA in Washington, D.C.

Appendix 2. Selected Economic Indicators

(year 2003 data, except where otherwise indicated)

	Costa Rica	El Salvador	Guat-emala	Hon-duras	Nicar-agua	Dom. Rep.
GDP ($ billions)	17.5	14.7	24.0	6.8	2.7	20.5
GDP Growth (%)	5.0	2.2	2.4	1.5	2.3	-1.3
GDP Growth 1980-1990 (%)*	3.0	0.2	0.8	2.7	-1.9	3.1
GDP Growth 1990-2002 (%)*	4.9	4.3	4.0	3.1	4.3	6.0
PPP Per Capita Gross National Income**	8,560	4,190	4,030	2,540	2,350	6,270
Inflation (%)	9.3	2.8	5.5	9.8	6.1	28.0
Current Account Balance (% of GDP)	-5.9	-4.5	-4.3	-7.6	-17.6	4.5
Pop. Below $1 per day (%)***	2.0	31.1	16.0	23.8	45.1	<2.0
Human Development Index (HDI) Rank#	42	105	119	115	121	94

Sources: World Bank, *World Development Indicators 2004*, pp. 14-15, 54-55, and 178-83, United Nations, *Human Development Report, 2003*, and IMF website.
* Average annual percent growth.
** Gross national income (GNI) converted to international dollars using purchasing power parity rates. An international dollar has the same purchasing power over the GNI as a U.S. dollar has in the United States. GNI, formerly represented as GNP by the World Bank, is a different, but similar measure as GDP. Data are for year 2002.
*** Percentage of population living on $1 per day or less, most recent survey year.
# HDI is a composite measure (education, income, and life expectancy) of average achievement in human development. A lower ranking is better: e.g. United States (7), Italy (21), and South Korea (30). The 2003 report reflects data for year 2001.

Appendix 3. U.S. Merchandise Trade with CAFTA Countries

($ millions)

Country	1998	1999	2000	2001	2002	2003	% Change 2002-2003	% Change 1998-2003
U.S. Exports								
Costa Rica	2,296	2,381	2,460	2,502	3,117	3,414	9.5%	48.7%
Honduras	2,318	2,370	2,584	2,416	2,571	2,844	10.6%	22.7%
Guatemala	1,938	1,812	1,901	1,870	2,044	2,274	11.3%	17.3%
El Salvador	1,514	1,519	1,780	1,760	1,665	1,824	9.6%	20.5%
Nicaragua	336	374	379	443	437	503	15.1%	49.7%
Dominican Rep	3,944	4,100	4,473	4,398	4,250	4,214	-0.8%	6.8%
Total CAFTA	12,346	12,556	13,577	13,389	14,084	15,073	7.0%	22.1%
Mexico	78,772	86,909	111,349	101,296	97,470	97,457	0.0%	23.7%
LAC*	63,396	55,153	59,283	58,157	51,551	52,036	0.9%	-17.9%
Latin America	142,168	142,062	170,632	159,453	149,021	149,493	0.3%	5.2%
World	682,138	695,797	781,918	729,100	693,103	723,743	4.4%	6.1%
U.S. Imports								
Costa Rica	2,745	3,968	3,539	2,886	3,142	3,362	7.0%	22.5%
Honduras	2,544	2,713	3,090	3,127	3,261	3,312	1.6%	30.2%
Guatemala	2,072	2,265	2,607	2,589	2,796	2,945	5.3%	42.1%
El Salvador	1,438	1,605	1,933	1,880	1,982	2,019	1.9%	40.4%
Nicaragua	453	495	589	604	679	769	13.3%	69.8%
Dominican Rep	4,441	4,287	4,383	4,183	4,169	4,455	6.9%	0.3%
Total CAFTA	13,693	15,333	16,141	15,269	16,029	16,862	5.2%	23.1%
Mexico	94,629	109,721	135,926	131,338	134,616	138,073	2.6%	45.9%
LAC*	50,266	58,464	73,348	67,370	69,503	78,857	13.5%	56.9%
Latin America	144,895	168,185	209,274	198,708	204,119	216,930	6.3%	49.7%
World	911,896	1,024,618	1,218,022	1,140,999	1,161,366	1,259,396	8.4%	38.1%
U.S. Balance of Trade								
Costa Rica	-449	-1,587	-1,079	-384	-25	52		
Honduras	-226	-343	-506	-711	-690	-468		
Guatemala	-134	-453	-706	-719	-752	-671		
El Salvador	76	-86	-153	-120	-317	-195		
Nicaragua	-117	-121	-210	-161	-242	-266		
Dominican Rep	-497	-187	90	215	81	-241		
Total CAFTA	-1,347	-2,777	-2,564	-1,880	-1,945	-1,789		
Mexico	-15,857	-22,812	-24,577	-30,042	-37,146	-40,616		
LAC*	13,130	-3,311	-14,065	-9,213	-17,952	-26,821		
Latin America	-2,727	-26,124	-38,642	-39,256	-55,103	-67,437		
World	-229,758	-328,821	-436,104	-411,899	-468,263	-535,653		

Source: Table created by CRS from U.S. Department of Commerce data.
* Latin America and the Caribbean, except Mexico.