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DR-CAFTA: Regional Issues

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Summary

On August 5, 2004, the United States signed the U.S.- Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) with five Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) and the Dominican Republic. DR-CAFTA could have a significant effect on U.S. relations with the region, primarily by establishing a permanent reciprocal trade preference arrangement among the signatory countries. DR-CAFTA must now be ratified by each country's legislature and approved by the U.S. Congress before taking effect. Although DR-CAFTA has been ratified by three of the six legislatures (El Salvador, Honduras, and Guatemala), opposition to the agreement exists in many of the signatory countries. Opposition groups have expressed concerns about the lack of transparency during the negotiation and ratification processes. Other regional concerns focus on DR-CAFTA's likely effects on the rural poor, labor conditions, the environment, and domestic laws. The U.S. Senate approved legislation (S. 1307) to implement the pact on June 30, 2005, and the House is expected to act on similar legislation (H.R. 3045) in July 2005. For more information, see CRS Report RL32322, *Central America and the Dominican Republic in the Context of the Free Trade Agreement (DR-CAFTA) with the United States*, and CRS Report RL31870, *The Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA)*. This report will be updated periodically.

Introduction

On August 5, 2004, the United States signed the U.S.- Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) with Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic. The Central American countries and the Dominican Republic are small countries with limited resources. Populations range from 4 million in Costa Rica to 12 million in Guatemala, with per capita income ranging from \$730 for Nicaragua to \$4,280 for Costa Rica. Most of these countries are classified by the World Bank as lower middle-income countries. Exceptions include Costa Rica, an upper middle-income country, and Nicaragua, a low-income country (the second poorest in the hemisphere). The combined Gross Domestic Product (GDP) of Central America and the Dominican Republic is equal to less than 1% of U.S. GDP and the total population of the countries is 44 million, compared to the U.S. population of 295 million.

The United States is the most important trading partner and source of foreign investment for all six countries. DR-CAFTA has been ratified by the legislatures of El Salvador, Guatemala, and Honduras. The ratification debate continues in Costa Rica, the Dominican Republic, and Nicaragua. In the United States, the Senate approved legislation (S. 1307) to implement the pact on June 30, 2005, and the House is expected to act on similar legislation (H.R. 3045) in July 2005. DR-CAFTA would not enter into force until the United States and at least one other country pass implementing legislation.

Foreign Policy Implications of DR-CAFTA

While most of the congressional debate on DR-CAFTA has focused on the domestic impact of the agreement, the foreign policy implications have also been raised. Throughout the 20th century, U.S. interest in Central America and the Dominican Republic has oscillated between periods of attention and neglect. U.S. involvement has been heavily driven by broader foreign policy concerns such as the spread of communism. In the 1980s, substantial amounts of U.S. assistance were provided to support Central American governments battling leftist insurgencies and to finance the U.S.-backed contras seeking to overthrow a revolutionary regime in Nicaragua. With the dissolution of the Soviet Union in 1991, U.S. concerns about spreading communist influence lessened, as did levels of assistance to the region. Other large U.S. assistance packages to the DR-CAFTA countries have occurred in response to natural disasters, including \$1 billion to the Central American countries devastated by Hurricane Mitch in 1998. One exception to this episodic involvement has been the preferential trade arrangement extended to the region since the early 1980s as part of the Caribbean Basin Initiative (CBI).

Proximity ties the DR-CAFTA countries to the United States and so there is a shared sense of security interests, including the illegal trafficking of arms, drugs, and people; gangs; and terrorism. Since the early 1990s, all of the DR-CAFTA countries have taken steps to promote democracy, protect human rights, and pursue market-led economic growth. Significant threats to security and stability remain, however, such as poverty and income inequality, crime, corruption, and institutional weakness. Regional leaders have asserted that DR-CAFTA is essential to strengthening the viability of their economies, which they assert will support political stability. If DR-CAFTA is rejected, they maintain that this would indicate that the United States can “sign something but not deliver,” and could undermine U.S. status and influence across Latin America.¹

On May 17, 2005, Deputy Secretary of State (and former U.S. Trade Representative) Robert Zoellick made a speech linking approval of DR-CAFTA to U.S. strategic interests in the region. Zoellick noted the disastrous consequences of prior U.S. neglect of Central America. He argued that if the United States fails to support the fragile democracies there now by approving DR-CAFTA, higher poverty and more illegal immigration could result. Others have added that a failure to approve DR-CAFTA could discourage other countries from continuing their own reform efforts in hopes of entering into FTAs with the United States. Critics of DR-CAFTA have dismissed these assertions as exaggerations, asserting that even if DR-CAFTA is rejected, countries in the region would still have preferential access to the U.S. market under existing CBI and related programs. They further maintain

¹ “Latin Lessons: The U.S. Faces a Loss of Leadership in a Troubled Region,” *Financial Times*, May 17, 2005.

that the DR-CAFTA countries would still receive U.S. foreign assistance, and would continue working with U.S. officials on issues of shared concern such as immigration and drug trafficking.²

Ratification Status

In Central America, the legislatures of El Salvador, Honduras, and Guatemala have ratified DR-CAFTA. All three countries have experienced popular protests against the agreement. On December 7, 2004, the Legislative Assembly of El Salvador ratified the DR-CAFTA despite strong objections from the leftist Farabundo Marti Liberation Front (FMLN). After more than 19 hours of floor debate and a brief takeover of the chamber by protestors, DR-CAFTA was ratified by a vote of 49-35. Honduras followed on March 3, 2005 by a final vote of 124-4 showing strong support for the agreement from both major parties. This result may not reflect opposition to the FTA among farmers, public sector workers, and the poor, whose interests are under-represented in the Honduran legislature. After a March 3 vote had to be postponed because of ongoing popular protests, Guatemala became the third country to ratify DR-CAFTA on March 10, 2005 by a vote of 126-12. In order to win support for the FTA, the Guatemalan government has promised complementary measures that would promote investment in rural infrastructure development and social service delivery. Despite these initiatives, protesters have continued to speak out against the agreement. Clashes with police in Guatemala have led to arrests, injuries, and at least one death.

The DR-CAFTA ratification debate continues in the Dominican Republic, Nicaragua, and Costa Rica. According to the U.S. Embassy in the Dominican Republic, a reputable poll conducted in April/May 2005 found that 60% of Dominicans are aware of DR-CAFTA; of those, 50% support the agreement. The Dominican government strongly supports DR-CAFTA as a means of continuing the country's economic recovery. The business community generally supports the agreement. As long as compensation mechanisms can be developed to compensate sugar producers and other sectors that may be adversely affected by DR-CAFTA, the Dominican Congress is soon likely to approve the agreement. In Nicaragua, the opposition Sandinistas, who control 38 of the 92 seats in the National Assembly, strongly oppose DR-CAFTA. Opponents are concerned that the FTA may lead to the privatization of public services and may threaten the livelihood of the country's farmers who comprise 45% of the workforce. The National Assembly has indicated that it will seek complementary legislation for trade capacity building and will not vote on DR-CAFTA before the U.S. Congress does so. In Costa Rica, the most developed DR-CAFTA country, President Pacheco has not presented the FTA to the Legislative Assembly. Opposition groups fear the agreement may compromise the country's high environmental standards and force the privatization of its well-functioning telecommunications system. Press reports indicate that Costa Rica may not consider the pact until after presidential elections are held there in February 2006.³

² Robert B. Zoellick, Deputy Secretary of State, "From Crisis to Commonwealth: Crisis and Democracy in Our Neighborhood," May 16, 2005; "The CAFTA Vote is About More Than Trade," *Financial Times*, May 16, 2005.

³ See "Central American Presidents, Avoiding Protests at Home, Tour U.S. to Garner Support for DR-CAFTA," Washington Office on Latin America (WOLA), May 10, 2005; U.S. Southern (continued...)

Regional Concerns

On May 10-11, 2005, the presidents of the DR-CAFTA countries traveled throughout the United States in an effort to build support for the agreement. They and other advocates of the agreement argue that it will help spur needed economic growth and consolidate democratic progress made in the region by creating institutional structures that could strengthen the rule of law and prevent opportunities for corruption. They also maintain that increased competition from foreign firms, as well as ongoing international scrutiny that would result from DR-CAFTA would provide extra incentives to enact deeper reforms. Support for the agreement within the DR-CAFTA countries is far from uniform, even in the countries whose legislatures have already ratified the agreement. Critics of DR-CAFTA in the region include labor unions, environmentalists, indigenous and peasant groups, the Catholic church, and some political parties. They argue that, as negotiated, DR-CAFTA has inadequate labor and environmental provisions, limits access to generic drugs necessary for fighting diseases like HIV/AIDS, and unfairly pits subsidized U.S. agricultural interests against the region's subsistence farmers. Public sector workers also fear provisions in DR-CAFTA that may hasten the privatization of state-run programs.

Transparency in Government. Since the early 1990s, the DR-CAFTA countries have sought, with varying degrees of success, to develop transparent and accountable democratic institutions. Strong institutions that encourage dialogue and citizen participation are critical to establishing viable democracies in countries that have long been polarized by political, ethnic, and class differences and plagued by official corruption. In July 2004, U.S. and Central American Catholic bishops issued a joint communique expressing concern about the lack of transparency in the negotiations for CAFTA in Central America. They noted that, with the exception of Costa Rica, information on the agreement was not made available to the public and that members of civil society were excluded from the negotiation process. Similar concerns have been expressed by NGOs and opposition legislators in El Salvador and Guatemala about the lack of public debate and time given for legislative scrutiny during those countries' ratification processes.⁴ Regional leaders have downplayed these problems, noting that trade capacity building (TCB) assistance related to DR-CAFTA will empower civic groups to demand increased accountability from their governments and private firms. They also maintain that DR-CAFTA will help improve government accountability by requiring transparency in customs administration, competitive bidding for government procurement, and stronger intellectual property protection.

³ (...continued)

Command "One Dead in Guatemala Protests Against Trade Deal with U.S.," Mar.16, 2005; Time for CAFTA," *Latin American Regional Report*, May 2005; "Costa Rica Balks at Free-Trade Pact," *Wall Street Journal*, May 3, 2005.

⁴ Joint Statement Concerning the CAFTA by the Bishop's Secretariat of Central America, and the United States Conference of Catholic Bishops, July 2004; "Central Americans Speak Out Against DR-CAFTA," Alliance for Responsible Trade, March 2005.

Effects on the Rural Poor.⁵ In 2004, the United Nations Development Program identified the persistent problems of poverty and inequality as two of the biggest obstacles to democratic consolidation in Latin America. Critics of DR-CAFTA have argued that the agreement might exacerbate the social and economic inequality, especially rural-urban income disparities, that are pervasive in much of the region. While most households stand to gain from lower prices associated with trade liberalization, some sectors — particularly subsistence and small farmers — could lose their livelihoods as a result of cheap agricultural imports from the United States as they did in Mexico under the North American Free Trade Agreement (NAFTA). World Bank researchers have concluded that the benefits of NAFTA did not reach Mexico's poor southern states, primarily inhabited by subsistence farmers, due to a lack of investment by the Mexican government in infrastructure, education, and local institutions. Those observers maintain that more transition support programs and technical assistance for small farmers are needed in the DR-CAFTA countries for all sectors of society to take advantage of trade liberalization. It is unclear to some who question DR-CAFTA whether the countries possess the political will and resources necessary to enact reforms needed for the rural poor to benefit from DR-CAFTA. Advocates of the agreement point out that Guatemala and Honduras have already designed national rural development plans that will complement DR-CAFTA.

Employment and Labor.⁶ DR-CAFTA is likely to affect employment and labor conditions in Central America and the Dominican Republic. Since global textile quotas were lifted in January 2005, 18 plants in four DR-CAFTA countries have closed and some 10,000 jobs have been lost. Some say that DR-CAFTA could mitigate the effects of textile job losses that are occurring as a result of increased competition from Asian producers. Others note that any jobs gained in export manufacturing could be offset by potential jobs lost in agriculture due to the likely influx of U.S. agricultural products.

While the Office of the U.S. Trade Representative (USTR) asserts that labor laws in the CAFTA countries generally comply with the ILO's core labor standards, critics argue that those laws are well below international norms. Enforcement of domestic labor laws is weak in many CAFTA countries, including in some export processing zones (EPZs). In El Salvador, for example, factories have no collective bargaining agreements in place with the 18 unions active in the EPZs, and workers there have reported sexual harassment, as well as verbal, and even physical abuse. In Costa Rica, a country with good labor conditions, the legislature is considering legislation that would eliminate the 8-hour workday and reduce requirements for overtime pay. These news laws may be an

⁵ Sources include "Democracy in Latin America," *United Nations Development Program*, 2004; WOLA Issue Guide, *Fair Trade or Free Trade: Understanding CAFTA*, April 2004; Gerardo Esquivel et al, "Why NAFTA Did Not Reach the South," *World Bank*, June 2002, Andrew Mason, "Policy Approaches to Managing the Transition: Ensuring that the Poor Can Benefit from DR-CAFTA," *World Bank*, May 11, 2005.

⁶ Sources include "Fraying of a Latin Textile Industry," *The New York Times*, March 25, 2005; U.S. Department of State, *Country Reports on Human Rights Practices 2004: El Salvador*, March, 2005; "Guatemala Third Country to Ratify DR-CAFTA as Others Hold Back," *Inside U.S. Trade*, March 11, 2005; "Labor Groups Petition USTR to Review FTA Partners' GSP Eligibility," *Inside U.S. Trade*, December 24, 2004; USTR, "CAFTA's Strong Protections for Labor Rights," CAFTA Policy Briefing Book, February 2005; "CAFTA's Weak Labor Rights Protections: Why the Present Accord Should be Opposed," Human Rights Watch, March 2004. See CRS Report RS22159, *DR-CAFTA Labor Rights Issues*, by Mary Jane Bolle.

effort to keep the country competitive with other CAFTA countries that pay lower wages. In December 2004, labor groups filed complaints asking USTR to review the labor practices of four of the DR-CAFTA countries regarding their continued eligibility for Generalized System of Preferences (GSP) trade benefits.

Regional officials maintain that DR-CAFTA has a three-pronged strategy to improve labor conditions in the region. The agreement calls for the enforcement of domestic labor laws, violations of which may be enforced by monetary fines and dispute resolution proceedings; commits the countries to working with the ILO to bring their laws up to international standards; and provides technical assistance to help build country capacity to enforce labor laws. Trade Representative Rob Portman has called for an international donors' conference to further increase such assistance. Critics contend that most of DR-CAFTA's labor provisions are unenforceable as countries may simply reduce their budget for labor-related programs to pay for any fines they may incur, and that the oversight found in unilateral U.S. programs, such as the GSP, will be lost under DR-CAFTA.

Environment.⁷ Tourism is a major source of revenue for most of the DR-CAFTA countries. The DR-CAFTA countries rely on the beauty of their natural surroundings to attract foreign visitors. All five Central American countries have passed a general framework law on the environment, and amended their constitutions to include the government's obligation to protect the environment. But as the USTR notes, the Central American governments' ability "to effectively implement and enforce environmental laws is limited by the lack of fiscal and human resources." While Costa Rica has strong environmental laws that are strictly enforced, many other countries in the region do not. Some environmentalists have expressed concerns that development associated with DR-CAFTA could exacerbate the region's existing environmental problems. In apparent response to criticism that the DR-CAFTA Environmental Cooperation Agreement (ECA) was weak, signatories concluded two supplemental agreements in February 2005. These agreements will be supported by U.S. funding for technical assistance to enforce environmental standards and to implement the ECA.

Impact on Domestic Laws. There have been concerns expressed in the DR-CAFTA countries about changes in their domestic laws that may have to occur in order to comply with the agreement's provisions. The Dominican Republic and Guatemala have already had to repeal domestic laws that the USTR found to be in breach of DR-CAFTA obligations: the former a tax on beverages containing high-fructose corn syrup, and the latter a law changing the five-year protection period for clinical trial data used to certify patented drugs. Costa Rica will have to make substantial legislative changes in order to open up its telecommunications and insurance sectors to foreign competition. Civil society groups reportedly fear that DR-CAFTA provisions will make it difficult, if not impossible, for governments in the region to preserve essential public services, and to develop new initiatives that respond to local needs for sustainable development programs. Proponents of the agreement say that some of the reforms required by DR-CAFTA, though difficult, may be necessary for the DR-CAFTA countries' economies to become more efficient, transparent, and competitive.

⁷ USTR, *Interim Environmental Review: U.S.-Central America Free Trade Agreement*, Aug. 2003; Quixote Center, "CAFTA and the Environment," July 2004; "DR-CAFTA Countries Sign Two Pacts to Boost Environmental Cooperation," *International Trade Reporter*, Feb. 24, 2005.