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Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR)

Overview

CAFTA-DR is a free trade agreement (FTA) among the United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic. It eliminates tariff and non-tariff barriers on goods, services, and agriculture, building on unilateral trade preferences begun under the 1983 Caribbean Basin Initiative (CBI). The agreement reinforces Congress's historical support for trade as a foundation of broader foreign economic, political, and security policies in the region.

CAFTA-DR Facts

Milestones. Negotiations began in January 2003 with the Dominican Republic joining in January 2004. The CAFTA-DR agreement was signed on August 5, 2004. The Senate passed implementing legislation 54 to 45 on June 30, 2005, with the House following in kind 217 to 215 on July 28, 2005. It was signed into law on August 2, 2005 by President Bush (P.L. 109-53). The agreement entered into force on a rolling basis: with El Salvador, Honduras, Nicaragua, and Guatemala by July 1, 2006, the Dominican Republic on March 1, 2007, and Costa Rica on January 1, 2009.

CAFTA-DR Provisions. The agreement has 22 chapters including provisions on tariff and non-tariff barrier elimination, rules of origin, customs procedures, sanitary and phyto-sanitary measures, government procurement, investment, trade in services, intellectual property rights protection, labor, environment, and dispute settlement.

Trade Preferences. The agreement replaced U.S. unilateral preferential trade treatment extended to CAFTA-DR countries under the Caribbean Basin Economic Recovery Act (CBERA), the Caribbean Basin Trade Partnership Act (CBTPA), and the Generalized System of Preferences (GSP).

What Are Supporting Views?

Proponents of CAFTA-DR view the agreement as an instrument to boost trade and economic growth, enhance prosperity in CAFTA-DR countries, increase employment opportunities, and promote broader foreign economic policy interests in the region. Supporters also view the agreement as a way to reinforce economic stability and to encourage regional economic integration. Deeper economic ties with the United States can complement foreign policy objectives in promoting democracy, the rule of law, and efforts to fight organized crime and drug trafficking. Some studies suggest that the agreement has been an effective tool for promoting worker rights protection and advancing social citizenship issues in the political agenda of Central America and the Dominican Republic.

What Are Opposing Views?

When CAFTA-DR was being considered, many lawmakers were concerned about possible effects on U.S. labor and sensitive industries (sugar and textiles), as well as other trade issues such as intellectual property rights protections and investor-state relations. Some policymakers wanted better trade adjustment and capacity building policies to address potential negative effects on vulnerable sectors in partner countries, such as the apparel industry and agriculture. Ongoing criticisms of the agreement point to the region's pervasive social and economic inequality, poor working conditions and inadequate enforcement of labor laws. Since the agreement's entry into force, labor groups and human rights advocates contend that some countries have failed to comply with their labor obligations. For example, they charge that some manufacturing plants fail to pay workers the proper wages or provide pensions. Other critics argue that governments in the region are unable or unwilling to provide labor reforms and need to work more to strengthen enforcement mechanisms.

What are the Effects of the Agreement?

CAFTA-DR deepened the trade partnership between the United States and partner countries by transitioning the relationship from one of trade preference arrangements to a binding reciprocal FTA among the parties. The agreement's more flexible rules of origin than those under trade preference programs provided incentives for regional integration among Central America and the Dominican Republic. It also enhanced trade-related rules and disciplines for services, especially in telecommunications, intellectual property rights protection, government procurement, and investment. Because most U.S. imports from the region had already been duty free under normal trade relations or trade preference programs, CAFTA-DR's effect on the U.S. economy has been small.

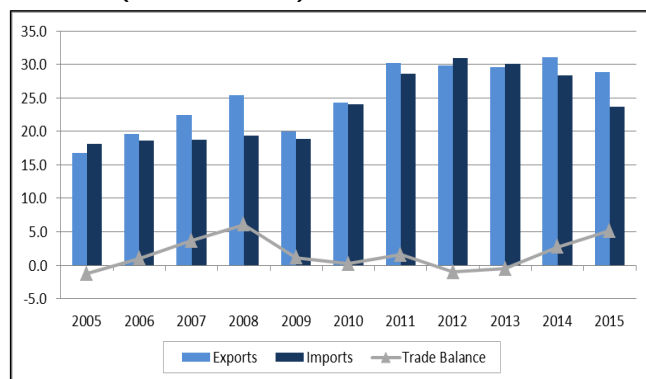
Regional Integration

CAFTA-DR reinforced regional integration with rules of origin that allow for greater production-sharing among Central American and Mexican producers using U.S. inputs. Harmonization of rules of origin and lower trade barriers have enabled the region to become more competitive by increasing co-production relationships, allowing for greater economies of scale in production, as well as greater market access to each other's markets more generally. This includes reciprocal trade rules for U.S. duty-free treatment of imports assembled from inputs produced in Central America or Mexico. For example, fabric and yarns produced in the United States are used in apparel production in CAFTA-DR countries, with final goods receiving duty-free treatment in the United States.

Merchandise Trade Trends

The United States is the dominant trade partner for CAFTA-DR parties, although its market share has fallen slightly over the past decade. In 2015, 41% of exports from CAFTA-DR countries went to the United States, down from 52% in 2005, while 37% of their imports came from the United States, down from 40% in 2005. U.S. trade with partner countries increased since the agreement's entry into force, with U.S. exports increasing faster than imports. Aggregate U.S.-CAFTA-DR bilateral trade data show that between 2005 and 2015, growth in U.S. exports (71.8%) outpaced U.S. imports (31.3%), while the U.S. trade balance moved from a deficit of \$1.2 billion in 2005 to a surplus of \$5.2 billion in 2015 as shown in **Figure 1**.

Figure 1. U.S. Merchandise Trade with CAFTA-DR Partners (US\$ in billions)



Source: Compiled by CRS using data from ITC.

Composition of Trade

Over the past decade, more sophisticated and higher-value exports from CAFTA-DR countries have grown, while exports of light manufactures such as apparel have stagnated or declined. Agricultural trade has increased moderately. The share of textiles and apparel trade among the partners has declined slightly over the past ten years, while trade in higher-value products such as medical equipment and semiconductors has increased. For example, U.S. imports of medical equipment and auto parts increased by 105% and 195%, respectively, between 2005 and 2015. In comparison, U.S. apparel imports decreased by 10%.

In 2015, major U.S. exports to CAFTA-DR countries included petroleum and coal products (18%); fibers, yarns and threads (5%); oilseeds and grains (4%); resin and synthetic rubber products (4%); communications equipment (3%); and fabrics (3%). Major U.S. imports included apparel (33%); fruits and tree nuts (13%); medical equipment and supplies (8%); motor vehicle parts (5%); tobacco products (4%); and semiconductors (3%).

Foreign Direct Investment

FTAs are often considered equally important for attracting foreign direct investment (FDI) as they are about trade. FDI flows are a measure of a country's foreign attractiveness. An FTA can encourage FDI through two channels. First, permanent preferential access to the U.S. market reassures potential investors that access to the largest market is more stable. Second, enhanced investment rules protect investors in other countries.

The United States is the largest investor in CAFTA-DR countries, although the stock of FDI has decreased since 2005, according to the Bureau of Economic Analysis. Investment is also influenced by macroeconomic conditions, making it difficult to assess the FTA's impact. The services sector is the leading recipient of FDI in the region. Costa Rica attracted the highest levels of new FDI flows from the United States in 2014, followed by Guatemala, and Dominican Republic. Costa Rica and the Dominican Republic have the highest wage rates and manufactured exports in the region, indicating that investment is not necessarily drawn to low-cost producers, but rather to countries that have relatively higher levels of stability, education, and productivity.

Labor Issues

The labor chapter was a strong point of contention in the CAFTA-DR congressional debate, divided largely along party lines and revolving around three issues: whether CAFTA-DR countries' laws complied with International Labor Organization (ILO) basic principles; whether the countries had the ability to enforce their laws; and whether the labor chapter could compel legal compliance and enforcement. In a 2005 report by the labor ministers, CAFTA-DR countries recognized that they lacked the financial resources and technical expertise to enforce good labor practices. They identified their areas of concern and recommended actions to improve worker rights, enhance capacity, and promote a culture of compliance with labor standards. The United States has submitted three labor submissions under CAFTA-DR alleging that the Dominican Republic, Honduras, and Guatemala failed to comply with their commitments. The United States has engaged extensively with the three governments to resolve the cases and negotiated labor action plans with each country. The cases have been slow moving. It took three years from the time of the AFL-CIO submission against Honduras to the issuance of a Department of Labor Report. Only the pending case against Guatemala has proceeded past the consultation stage of the dispute settlement process.

Issues for Congress

The proposed Trans-Pacific Partnership agreement (TPP) and the rising number of trade agreements throughout the world have implications for U.S. trade policy. The United States has FTA agreements with eleven Latin American countries, three of which are parties to the TPP. Some CAFTA-DR countries have expressed an interest in joining the TPP if it is approved by Congress. While it is uncertain whether this is a possibility, the United States may consider other options to build upon this economic relationship. One possibility could be to harmonize rules of origin and allow regional cumulation with TPP countries to encourage production sharing. Another option is to consider a trade facilitation agenda to make trade more efficient. Latin American countries are increasingly searching for ways to work together as a region. The United States could consider increasing commercial dialogues with them to advance its trade policy agenda in the Western Hemisphere.

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