CAFTA:
A Narrow Passage Through Troubled Waters

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The Central American Free Trade Agreement (CAFTA) was approved on July 27, by a razor-thin vote margin of 217 to 215 in the House of Representatives, amidst a storm of controversy and protests from civil society, environmental and labor organizations and intense lobbying by some industries in the United States (US) and Central America.[**] CAFTA's approval coincided with increasing skepticism about the prospects for the Free Trade Area of the Americas (FTAA) and a growing concern about the state of US-Latin American relations. The high political capital cost required to obtain passage of the agreement may have included the collapse of the fragile compromise on trade between Republicans and Democrats, as only 15 Democrats voted to approve CAFTA. This compromise has made progress possible on numerous other trade agreements and is indispensable to achieving the FTAA.

The principal cause of the controversy surrounding the passage of CAFTA was the Bush Administration's and the Republican congressional majority's unwillingness to provide additional protection for workers and the environment beyond requiring the member countries to enforce their existing laws in both areas. A growing concern about the ballooning US trade deficit was also on the minds of opponents from both parties. The controversy surrounding CAFTA also will affect the FTAA negotiations, already delayed beyond the scheduled date for completion of January 2005. The FTAA faces increasing challenges from the MERCOSUR countries,[***] Venezuela and labor and environmental groups throughout the hemisphere. Now they also will have to contend with a growing opposition in Congress, aggravated by the partisan way in which CAFTA was approved.

The CAFTA debate sparked the specter of protectionism as textile, sugar and labor interests, among others, lobbied furiously against the agreement. The Hispanic community also was divided on the issue with the overwhelming majority opposed to the trade deal and only three Hispanic Democrats in Congress supporting approval of CAFTA. The deep division over the agreement does not augur well for future trade agreements, especially for the FTAA. It is clear that environmental and labor issues will have to be addressed in a

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[**] *Editor's Note: The Senate had approved CAFTA on June 30, 2005, by a vote of 54 to 45.*

[***] *Editor's Note: The members of MERCOSUR (the Southern Cone Common Market) are Argentina, Brazil, Paraguay and Uruguay.*

more balanced way in future agreements presented to Congress or risk the real possibility of rejection.

The CAFTA countries, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua, collectively constitute the United States' second largest market in Latin America, after Mexico, and its tenth largest in the world. They purchased approximately $16 billion in US manufactured and agricultural products last year and are expected to increase that amount by an estimated $2 billion next year under CAFTA. US exports to the CAFTA countries already surpass total exports to Russia, India and Indonesia, combined.

Central America is a natural trading partner for the United States. Geographic proximity and close cultural and community ties, enhanced by the large and growing community of immigrants to the US from the region, strengthen the economic and business relationships between the CAFTA countries and the United States. Remittances from immigrant families in the United States are significant and continue to provide a growing source of foreign exchange throughout the region, helping to finance additional purchases of US goods and services. Since most US firms doing business in Central America already operate on a regional basis, CAFTA will bring about additional opportunities to harmonize the Central American market and enable these firms to more effectively serve the new regional, integrated market.

In addition to trade benefits for US producers, CAFTA opens up new investment opportunities for US firms in physical infrastructure, such as roads, warehousing and port facilities, as well as in high-tech, telecommunications and financial industries. The agreement provides duty free treatment for 80 percent of US exports to CAFTA countries, leveling the playing field since 80 percent of CAFTA country products already entered the US duty free prior to CAFTA. The remaining tariffs will be reduced to zero over a period of five to 20 years.

In terms of trade benefits, CAFTA will provide only a modest increase in trade opportunities for the US, but for the Central American countries and the Dominican Republic, CAFTA provides not only an opportunity to increase exports but also to attract greatly needed foreign investment. For the US, CAFTA is seen as maintaining momentum for the FTAA at a time when the negotiations on the hemispheric trade agreement have stalled to almost a standstill. If in addition to CAFTA, the US is able to conclude an Andean Free Trade Agreement in the near future, the prospects for the FTAA will be greatly enhanced.

For the CAFTA countries, the increased US foreign direct investment and access to US technology combined with the increased duty free access to the US market represent significant benefits. More importantly, the psychological boost of the agreement will spur more entrepreneurship and greater job creation in Central America and the Dominican Republic, which are indispensable to creating sustainable development. Nevertheless, CAFTA firms will face stronger competition from US firms under the agreement.

Opponents of CAFTA argue that only the wealthy elites of Central America and the Dominican Republic will benefit from the agreement, and that it will have an adverse impact on workers, small businesses, farmers and the environment. They further contend that the net result of CAFTA will be an even wider gap between the rich and poor in these developing countries. This disparity in economic power and the resulting economic injustice has been the root cause of the political instability that has plagued these countries historically.

In addition to trade benefits, the Bush Administration argued to Congress that CAFTA would provide support for strengthening democracy in countries that have struggled with bitter internal political conflicts and regional warfare in the recent past.

If the agreement succeeds in promoting economic development in the CAFTA countries and helps to strengthen democratic institutions, it will justify the great effort the Bush Administration made to attain its approval by Congress. However, this remains an open question, and CAFTA is not a panacea for all the economic and political ills that affect this sub-region of the hemisphere. Bilateral and multilateral development assistance is still greatly needed to achieve equitable economic progress. Washington must be mindful of this in the immediate future.

CAFTA also has stirred the controversy over the US giving higher priority to regional agreements than to multilateral trade agreements. Ever since NAFTA was established, regional agreements have grown in number and scope and have come under fire from multilateralist proponents who argue that regional agreements cause trade distortion and create inconsistent trade standards. The multilateralists contend that regional trade deals detract from achieving global agreements that provide uniformity in trade standards and benefits for developed and developing nations worldwide. The United States started the process of bilateral and regional agreements in the late 1980s when it negotiated a bilateral agreement with Canada. Subsequently, it initiated negotiations in 1991 on NAFTA with Canada and Mexico, in part to pressure the Europeans to conclude the multilateral Uruguay Round of negotiations.

Although the US hoped that the threat of pursuing NAFTA would get the General Agreement on Tariffs and Trade (GATT) negotiations moving to conclusion, it was only after NAFTA was approved by Congress in 1993, that the Uruguay Round was completed. When the European nations realized that the United States, Canada and Mexico had formed the largest free trade zone in the world and would be competing much more effectively in global trade, they decided to move forward to achieve a successful completion of the multilateral negotiations. Following the new US regional trade strategy, the European Union negotiated several regional agreements of its own. Thereafter, the US and Mexico, individually, began negotiating a series of bilateral and regional agreements; CAFTA has been the most significant that the US has concluded in Latin America since NAFTA, although it pales in comparison to the latter in terms of significance.

The US is currently negotiating a regional trade agreement with the Andean nations and several bilateral agreements with other Latin countries, as well with other nations in other regions. This will add to the trend favoring such agreements over multilateral trade pacts negotiated under World Trade Organization (WTO) auspices. In addition to building pressure for moving the Doha Round of multilateral negotiations, the United States considers bilateral and regional trade agreements as building blocks for the FTAA and effective instruments for pressuring Brazil and the other MERCOSUR countries to move towards concluding the hemispheric negotiations. It is clear that, despite the criticism about their value, the US and the European Union perceive regional agreements like CAFTA to constitute building blocks towards larger regional agreements like the proposed FTAA, and eventually to achieve greater progress in multilateral deals.

Despite the criticism that these regional agreements are creating more difficulties for multilateral negotiations and agreements, they are providing momentum for expanding free trade throughout the world.

The criticism of bilateral and regional agreements seems a bit hypocritical, because the critical nations themselves continue to negotiate additional agreements of this type. The reality is that the leading trading nations in the world, for the most part, have concluded that the most effective way to achieve multilateral free trade is through bilateral and sub-regional agreements. Until the Doha Round is concluded, if it can be indeed successfully completed, and the WTO is able to achieve more efficient and timely reduction of trade barriers through multilateral agreements, the current trend favoring regional agreements can be expected to continue unabated.

CAFTA was initially foreseen as another building block for the FTAA, and it might have turned out that way, but the refusal of the Bush Administration and Congress to provide stronger protection for workers and the environment may have made it more of a stumbling rather than a building block. This should give pause to the administration in how it proceeds with the FTAA negotiations. In view of the perception in Latin America that the United States is ignoring the development needs of the region, it is more important than ever that the hemispheric negotiations produce an equitable trade deal soon and a solid foundation for creating a new spirit of community in the Americas.

Free trade has made a valuable contribution to international development in the past, despite the dislocations that have inevitably resulted from reduced protections for industries and workers. However, free trade must be focused, and be seen as enhancing development at home and abroad rather than just expanding profitable opportunities for multinational companies. When the dislocations are perceived to be too high in comparison to the potential benefits, opposition such as that which nearly defeated CAFTA will inevitably develop. It would be a mistake to ignore the issues that have caused the opposition to CAFTA in any ongoing and future trade negotiations. To do so risks failure for the FTAA negotiations and a rejection of future controversial trade agreements by a deeply divided Congress.