



The Central America Free Trade Agreement with the United States (CAFTA): Negotiations and Outcomes

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AGENDA

- Central America today
- CAFTA & Central America
- Negotiation of CAFTA
- Outcomes of CAFTA
- Issues around CAFTA
- Conclusions

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Central America: A natural bridge to the world



Central America is a geographic, logistic, economic, and cultural bridge between major countries and regions. Because of its geographic position, Central America is a natural bridge between North and South America, and between Pacific and Atlantic Oceans

Central America Today



Population 35 million
Area 500,000 Km²

2004

GDP US\$70 bn

**Per capita GDP PPP
US\$4,420**

GDP growth 3.1%

**Foreign capital net
inflow US\$ 2.3bn**

**US\$ 19.7 bn of Exports +
US\$ 6.0 bn in Tourism and
Remittances**

US\$ 28.8 bn of Imports

35% of Intra-regional trade

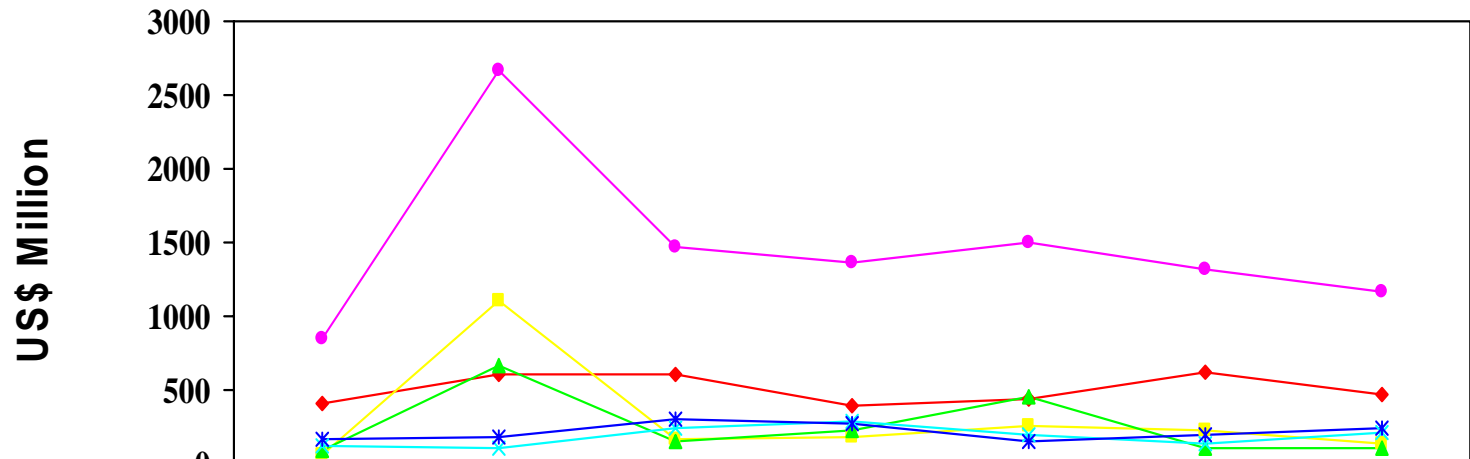
US\$ 10.3 bn Stock of FDI (1997-2003)

Source: Central Banks

Main exports from Central America

PRODUCT	Value 2002 US\$ Thousand	Average Growth 1998-2002 (%)
Accessories of computers & office machines	898,903	-1
Bananas and plantains, fresh or dried	840,722	-5
Coffee	788,944	-21
Electro-medical apparatus (electro-cardiographs, infra-red ray apparatus, syringes, dental)	355,293	55
Cane or beet sugar and chemically pure sucrose, in solid form	345,436	-4
Medicament mixtures	286,318	9
Dates, figs, pineapples, mangoes, avocados, guavas	178,293	4
Food preparations	160,171	11
Crude petroleum oils	149,382	23
Women's slips, panties, bathrobes etc.	130,253	12
Crustaceans	123,354	-22

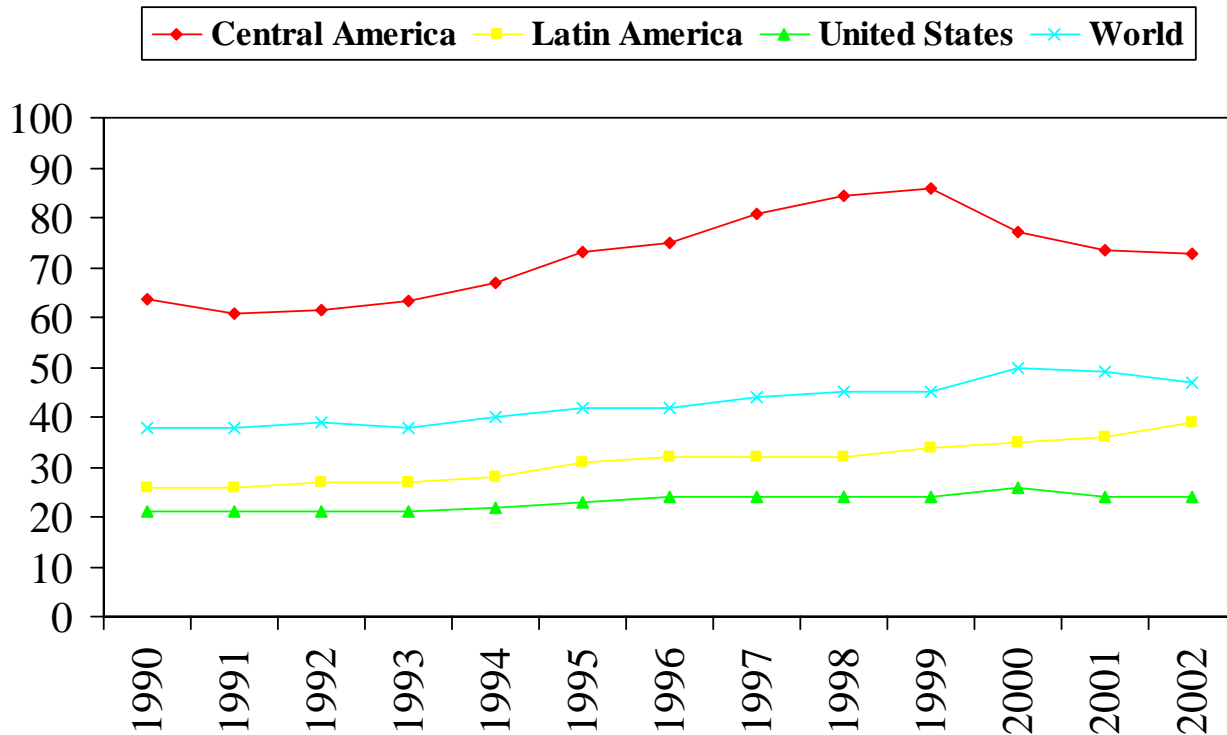
Foreign direct investment in Central America



	1997	1998	1999	2000	2001	2002	2003
—◆— Costa Rica	404	608	612	400	445	628	466
—■— El Salvador	59	1,103	162	178	260	234	139
—▲— Guatemala	84	673	155	230	456	110	104
—*— Honduras	128	99	237	282	195	143	216
—*— Nicaragua	173	184	300	267	150	204	241
—●— Total	848	2,667	1,466	1,357	1,506	1,319	1,166

Central America is an open region

Exports + Imports / GDP (%)



Average Tariffs

	1987	2003
Costa Rica	40	7
El Salvador	35	7
Honduras	37	7
Guatemala	39	7
Nicaragua	42	5

Source: World Development Indicators, and SIECA

FTAs in Central American countries

- Central America Economic Integration Agreement
- FTA CA3 and Mexico
- Agreement Guatemala-Cuba
- FTA Guatemala and Panama

- Canada
- Panama
- Colombia
- Venezuela
- Chile
- Andean Community

- Free Trade and Investment Agreement between Honduras, El Salvador, Guatemala – CA3 and Mexico.

- Mexico
- FTA CA4 and Canada



- Mexico
- Dominican Republic
- Chile
- Canada
- Trinidad & Tobago
- Panama

Investment Agreement with:

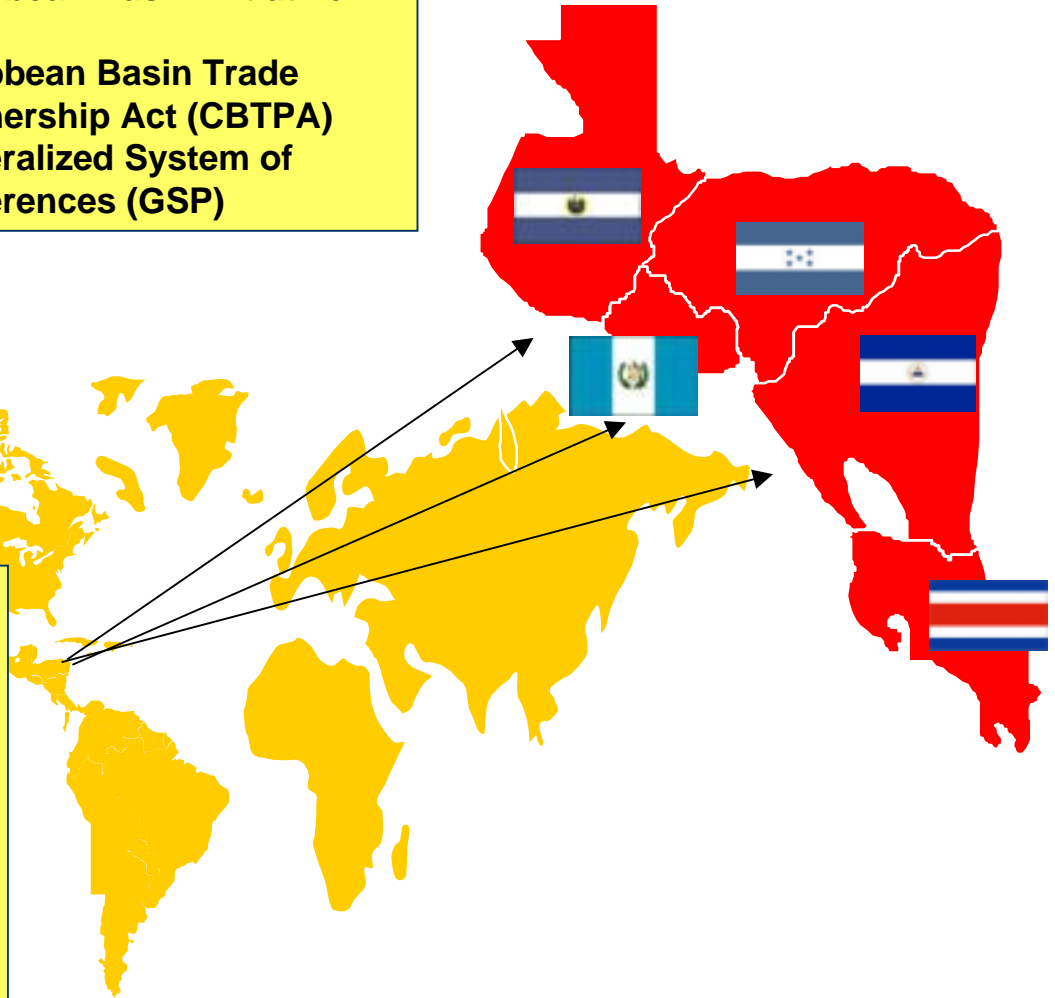
- Albania, Germany, Argentina, Austria, Bulgaria, Denmark, Spain, USA, France, Honduras, Italy, Jamaica, Japan, Norway, Poland, South Korea, Rumania and Taiwan

- Mexico
- Chile
- Dominican Republic
- Panama
- Central America Northern Triangle
- Canada

FTAs in Central America

- Caribbean Basin Initiative – CBI
- Caribbean Basin Trade Partnership Act (CBTPA)
- Generalized System of Preferences (GSP)

- Central American Customs Union
- Central America and Chile
- Central America and Panama
- General Agreement for CA Integration
- Central America and Dominican Republic
- CAFTA (To be ratified)
- WTO (Under negotiations)
- EU (Expected for 2006)



A Central American platform for trade and investment

Regional projects:

- Roads, ports and airports infrastructure and logistics modernization
- Customs Integration
- Electricity markets integration

Investment opportunities

- Telecommunications
- Energy
- High-tech Industries
- Financial services
- Distribution (wholesaling, franchising) and transport services
- Tourism
- Construction and engineering services
- Software development
- Agribusiness and Forestry



Global companies expanding investments and operations:

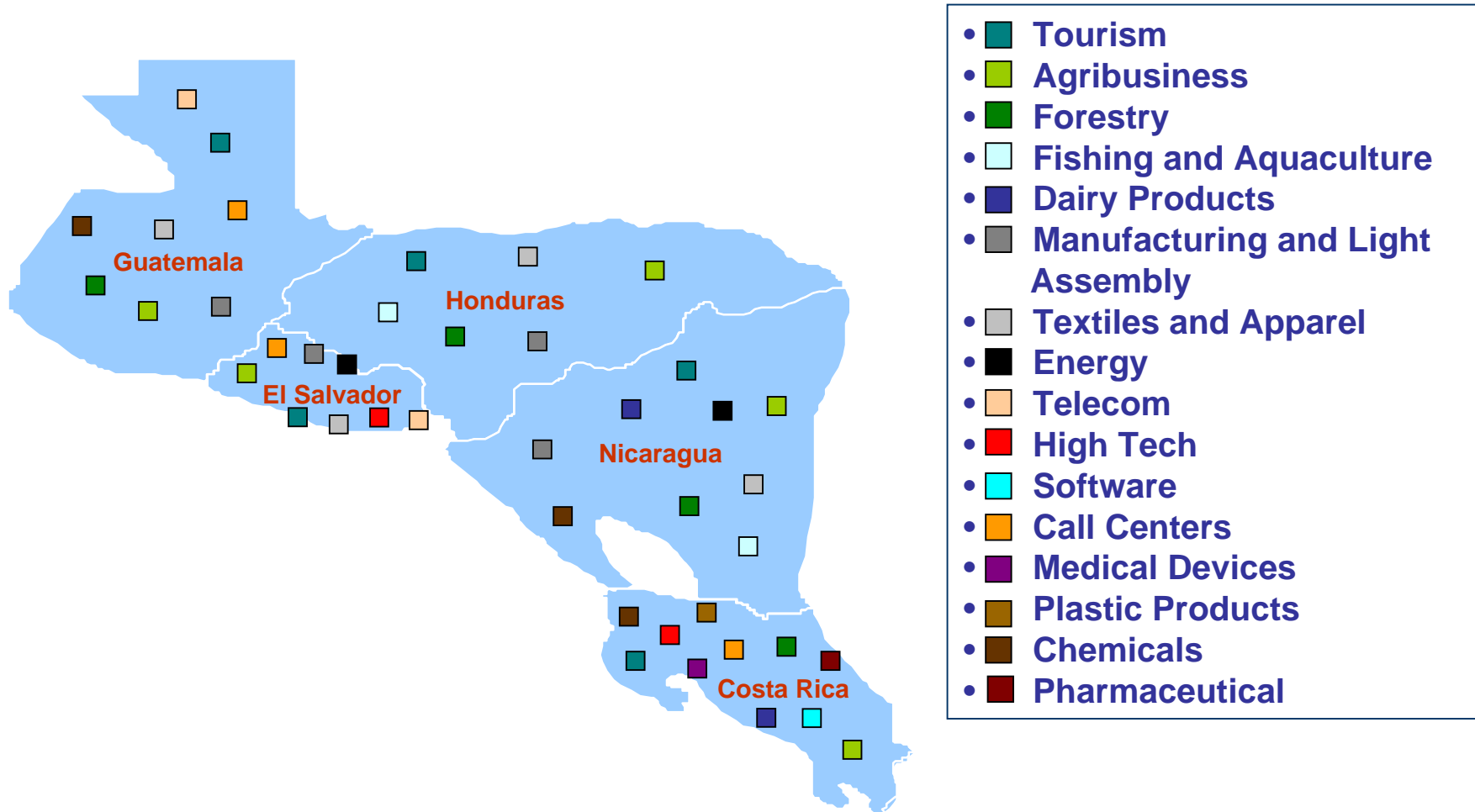
- Intel
- Procter & Gamble
- France Telecom
- Holcim
- Heineken
- Sakata Seed

**US\$11.3 Billion of FDI
in 1997-2003**

**Regional integration
Mexico, Chile and
Caribbean and FTAs
with several
countries**

**Perspectives on the
Free Trade Area of
the Americas and a
FTA with the
European Union**

Sectors with high potential for FDI attraction and exports



Source: CLACDS research

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CAFTA & Central America

- **CAFTA: US and CA5** - El Salvador, Guatemala, Honduras, Nicaragua and Costa Rica.
- The agreement is expected to be **ratified in year 2005** and **entry into force in year 2006**
 - Almost **50 per cent of the region's international trade** (exports and imports) **is made with United States**
 - The stock of **U.S. FDI** in the **region** amounts **US\$3 billion**
 - In year 2003, the **region exported** more than **US\$12 billion to the US market**
- **Nearly 100 per cent** of all consumer and industrial **products** made in Central America **will enter the U.S. market duty-free immediately on ratification** of the agreement

CAFTA & Central America

- CAFTA will **require** the **Central American countries** to **undertake reforms to improve its performance in critical competitiveness areas**: customs integration and administration, protection of intellectual property rights, access and protection of investments on utilities (energy, telecommunications, water), construction, insurance and financial services markets, sanitary and phytosanitary standards and certification schemes
- **“Agreement-pushed”** reforms and policy changes would create a better investment climate for US companies and at the same time **generate positive externalities for other foreign firms interested on investing in the region**

Trade between the U.S. and Central America

Exports of CA to the U.S. US\$12 billion

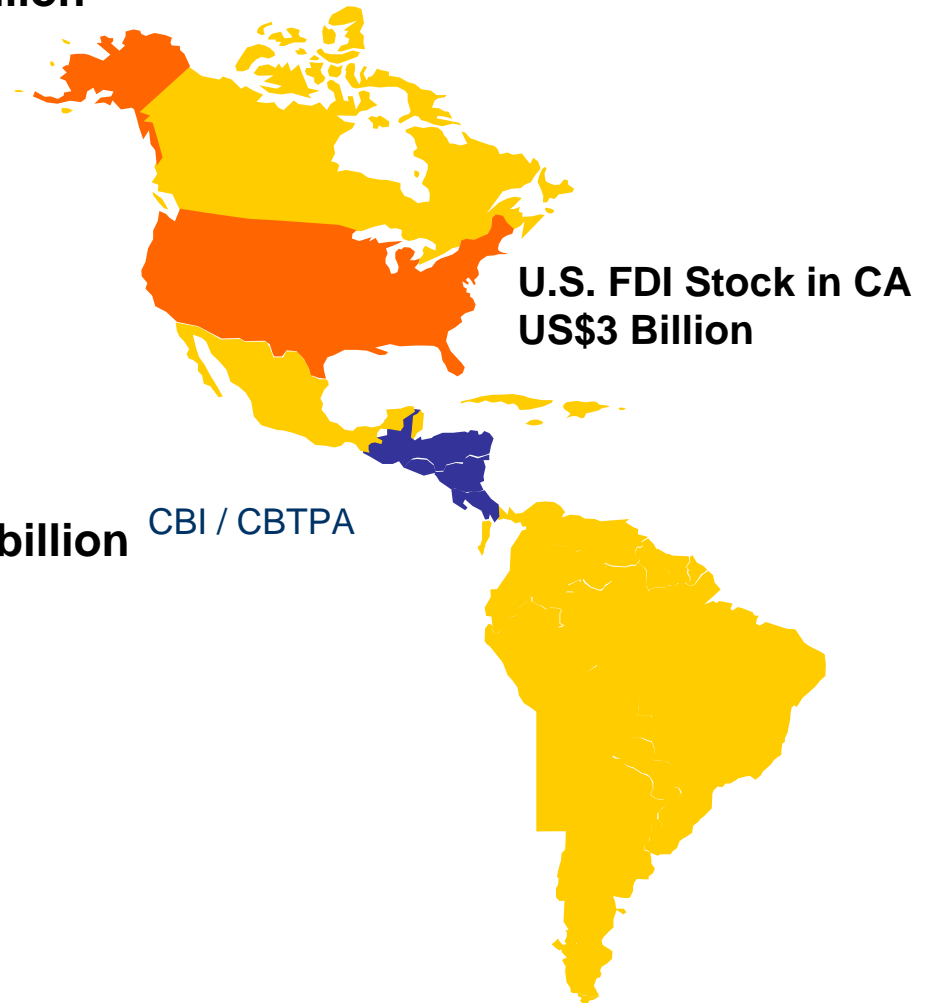
- 1% of total U.S. imports
- 55% of total CA exports

Textiles and Apparel	US\$ 7bn
Fruits	US\$ 1bn
Electrical Mach & Equip	US\$ 975m
Coffee	US\$ 446m
Medical Devices	US\$ 426m

Imports of CA from the U.S. US\$11 billion

- 1.4% of total U.S. exports
- 43% of total CA imports

Textiles and Apparel	US\$ 2.0bn
Electrical Mach & Equip	US\$ 1.7bn
Machinery & mechan.	US\$ 993m
Mineral fuels & prods	US\$ 698m
Plastics	US\$ 573m
Cereals	US\$ 447m



Source: USITC

Tariffs and sensitive products


Average Tariffs (%)	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
Average nominal external tariff	7.1	6.9	7.1	5.1	7.1
Capital goods	0	0	1	0	0
Inputs	0	0	1	0	0
Intermediate Goods	5 – 10	5 -10	5 – 10	5	5 - 10
Final Goods	15	15	15	15	15
Most Protected Industries (%)					
Diary products	15	40	20	40	65
Corn (yellow)	5-35	0	20	0-30	1
Rice	32	40	35	62	35
Sugar	20	40	40	55	50
Pork meat	15	40	15	15	48
Chicken meat	15	20	50	170	150

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Negotiation mechanisms

- All parties were subject to “the same set of obligations and commitments,” but with each country defining its own schedules (sensitive products) for market access on a bilateral basis
- Each country’s position was first determined at an internal level, establishing the margin for negotiation in each of the different sectors
- Finally, a Central American position was presented at each trade negotiation round



It was not possible to end the negotiation process with a joint Central American negotiating position, since the consensus-approach was suspended by the fourth round



Costa Rica negotiated longer, and obtained a slightly different agreement than the other four Central American countries, each of which also negotiated separate market access schedules

CAFTA Negotiation Rounds

- **First Round**, Costa Rica, January 2003

Public sector procurement, intellectual property, market access, investment services, dispute settlement, institutional arrangements, environment and labor

Basically served for negotiating teams to get to know each other

- **Second Round**, Ohio, February 2003

Phytosanitary measures, rules of origin, textiles, and customs regulations. Electronic commerce and investment chapters. Proposal for intellectual property rights, government procurement, and dispute settlement process. Creation of a Small Enterprise Development Center.

- **Third Round**, El Salvador, March-April 2003

Government procurement, market access, labor and the environment. Textiles, intellectual property rights, dispute settlement, investment and services, telecommunications, electronic commerce and agriculture

The tactic was to leave the “hardest” topics for last (rules of origin)

CAFTA Negotiation Rounds

- **Fourth Round**, Guatemala, May 2003

Guatemala offered immediate duty-free access to 93 percent of the incoming products from the United States

Drafts for all chapters under negotiation were available but no substantial progress was reached

- **Fifth Round**, Honduras, June 2003

Further disintegration in the Central American negotiating position

Costa Rica was the country most interested in defending its sensitive sectors

- **Sixth Round**, New Orleans, July-August 2003

Labor and environmental legislation and enforcement, dispute settlement mechanisms

Electronic commerce and customs procedures chapters concluded. Chapters on investment and government procurement were 90% complete. Significant progress in the Specific Rules of Origin for agricultural products, and the schedules for tariff reductions

- **Seventh Round**, Nicaragua, September 2003

Labor and environment chapters closed. Only one schedule for tariff reductions was established, that protects sensitive products for 15 years. Rules of origin and preferential access quotas (TPAs) for textiles discussed

CAFTA Negotiation Rounds

- **Eight Round**, Texas, October 2003
Investment chapter concluded. Consolidation of agricultural benefits under CBTPA.
Discussion on sensitive products, and sugar quotas
- **Nifth Round**, Washington, Decemeber 2003
All chapters closed.
Costa Rica was not happy with the results achieved at that date
- **Ninth Round (OT)**, Washington, January 2004 Costa Rica – U.S.
Details over state-run insurance and telecommunications sectors opening process, the treatment of certain sensitive agricultural products and duty-free treatment of apparel products made from materials outside the region
CAFTA signed by the five Central American countries

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General Results of CAFTA

Market Access

- No products are excluded from the agreement. Tariffs will be eliminated for all products, except: sugar-US, fresh potatoes and fresh onions-CR, white corn-C.A.
- More than 80% of U.S. exports of consumer and industrial products will be duty-free immediately upon entry into force of CAFTA, and 85% percent within five years. All remaining tariffs will be eliminated within ten years.
- Close to 98% of Central American exports to the U.S. exports will be duty-free immediately

Agriculture

- More than half of current U.S. farm exports to C.A. will be duty-free immediately
- Each C.A. country will have a separate schedule of access for U.S. products. The U.S. will provide the same tariff treatment to each of the five countries, but will make country-specific commitments on tariff-rate quotas.
- Sensitive goods (rice, beef, dairy, corn, poultry, pork) will have tariffs phased out incrementally in 5, 10, 15, or 20 years from the time the agreement takes effect.
- The U.S. and Central America will work to resolve sanitary and phytosanitary barriers to agricultural trade, in particular problems and delays in food inspection procedures for meat and poultry. C.A. will move toward recognizing export eligibility for all plants inspected under the U.S. food safety and inspection system.

General Results of CAFTA

Textiles and Apparel

- Textiles and apparel will be duty-free and quota-free immediately if they meet the Agreement's rule of origin. The agreement's benefits for textiles and apparel will be retroactive to January 1, 2004.
- Some apparel made in Central America that contains certain fabrics from NAFTA partners Mexico and Canada will have duty-free access, as well as apparel containing certain fabrics and materials in "short supply" in the U.S. and C.A.
- A "de minimis" provision will allow limited amounts of third-country content into CAFTA apparel, giving producers in both the US and C.A. needed flexibility.

Open Services Markets

- Substantial market access in service sectors (with very few exceptions):
 - Telecommunications, energy, transportation
 - Financial services, including banking, insurance and securities
 - Distribution services, such as wholesaling, retailing, franchising, express delivery
 - Computer, audiovisual, entertainment and related services
 - Construction and engineering services
 - Tourism
 - Professional services (architects, engineers, accountants, advertising, etc.)
 - Environmental services

General Results of CAFTA

Protections for Investors

- Secure, predictable legal framework for investors (all forms of investment: enterprises, debt, concessions, contracts and intellectual property)
- To provide U.S. investors in C.A. a basic set of substantive protections that Central American investors currently enjoy under the U.S. legal system.

Access to Government Procurement Contracts

- U.S. suppliers are granted non-discriminatory rights to bid on contracts from Central American government ministries, agencies, departments and state-owned enterprises. Low-value contracts are excluded.
- Requires fair and transparent procurement procedures (bribery in government procurement is specified as a criminal offense under C.A. and U.S. laws.)

Customs Procedures and Rules of Origin

- To ensure that only U.S. and C.A. goods benefit from the Agreement. Rules are designed to be easier to administer.
- Agreement requires transparency and efficiency in administering customs procedures, including the CAFTA rules of origin.
- Both parties will share information to combat illegal trans-shipment of goods. CAFTA facilitates rapid clearance through customs of express delivery shipments.

General Results of CAFTA

Protection and Promotion of Worker Rights

- CAFTA meets the labor objectives set out by Congress in the Trade Promotion Act of 2002 and makes labor obligations a core part of the agreement.
- Commit CAFTA countries to provide workers with improved access to procedures that protect their rights.
- All parties shall effectively enforce their own domestic labor laws, and this obligation is enforceable through the Agreement's dispute settlement procedures.

Commitments and Cooperation to Protect the Environment

- Agreement fully meets the environmental objectives set out by Congress in TPA. Environmental obligations are part of the core text of the trade agreement.

Dispute Settlement

- Core obligations of the Agreement, including labor and environment provisions, are subject to the dispute settlement provisions of the Agreement.
- Dispute panel procedures set high standards of openness and transparency.
- An enforcement mechanism includes monetary penalties to enforce commercial, labor and environmental obligations of the trade agreement.

Expected Effects of CAFTA

Study	Impact on U.S.	Impact on CA
USITC (2004)	<ul style="list-style-type: none"> • Welfare 0.01% of GDP • Exports growth to CA 15% (US\$2.7 Bn) • Imports growth from CA 12% (US\$2.8 Bn) 	n.a.
Hilaire and Yang (2004)	n.a.	<ul style="list-style-type: none"> • Welfare 1.5% of GDP (US\$3.9 Bn) • Exports growth to U.S. 50%
Brown et al. (2004)	<ul style="list-style-type: none"> • Welfare 0.17% of GDP (US\$17.3 Bn) 	<ul style="list-style-type: none"> • Welfare 4.4% of GDP (US\$5.3 Bn) • Exports growth to U.S. US\$8.3 Bn • Employment growth in textiles and apparel 28%

Expected effects in Central America

- Welfare improvement for Central American countries
- Higher household income levels / Higher wages
- Positive changes in GDP, but not too significant
- Trade flows (exports and imports) will grow
- Significant increase in U.S. imports (higher protection in C.A. vs. the U.S.)

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Opponents

&

Supporters

Central America

- Unions and labor organizations
- Agricultural organizations (non-exporters)
- Environmental organizations
- Academic institutions
- Political parties

United States

- Textiles and sugar producers
- AFL-CIO
- Environmental NGOs
- Democrats
- Some Republicans

International

- OXFAM
- Alliance for Responsible Trade

Central America

- Business organizations
- Exporters
- Governments
- Academic institutions
- Political parties

United States

- US Chamber of Commerce
- Emergency Committee for American Trade
- Government
- USAID

International

- The World Bank
- OAS
- IADB

Criticisms

- The negotiating texts were not to be disclosed by any of the Central American nations until they were concluded
- U.S. subsidies to agricultural goods
- Civil society felt “excluded from the process”, although a *side room* was set up to improve the communication between negotiators and interest groups
- Lack of transparency and information
- CAFTA would create unemployment and poverty
- “Underlying“ interests of the U.S.
- Lack of a “Parallel Development Agenda”

Central American Growth Competitiveness 2004-2005

Country	Growth Competitiveness Index Rank	Technology Index Rank	Public Institutions Index Rank	Macroeconomic Stability Index Rank
Finland	1	3	3	3
United States	2	1	21	15
Singapore	7	11	10	1
Chile	22	32	20	27
Ireland	30	37	17	21
Czech Republic	40	19	51	41
China	46	62	55	24
Costa Rica	50	55	47	64
El Salvador	53	69	46	53
Guatemala	80	79	84	79
Nicaragua	95	96	81	97
Honduras	97	93	100	82

*In a sample of 104 countries

Source: World Economic Forum (2004b)

Central American Business Competitiveness 2004-2005

Country	Business Competitiveness Index Rank		Sophistication of Company Operations and Strategy Rank		Quality of the National Business Environment Rank	
	2003	2004	2003	2004	2003	2004
United States	2	1	2	2	2	2
Finland	1	2	4	7	1	1
Singapore	8	10	12	13	4	8
Ireland	21	22	17	22	22	22
Chile	32	29	34	33	30	29
Czech Republic	35	35	33	31	38	37
China	46	47	42	39	44	47
Costa Rica	45	48	32	35	47	50
El Salvador	64	65	58	65	65	65
Guatemala	86	86	76	78	88	90
Honduras	95	97	89	91	96	100
Nicaragua	94	100	92	100	93	99

Source: World Economic Forum (2004a and 2004b)

*The number of countries surveyed in 2004 was 104 and 102 countries in 2003

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Conclusions - The negotiation process

- It was not possible to end the negotiation process with a joint Central American negotiating position, since the consensus-approach was suspended
- A general conclusion from the negotiations process is that the different level of skills among the teams, the diversity of interests of sectors, and the relative urgency of some countries, made a unified position impossible

Conclusions - Attitudes

- Most opposition to the agreement emerged from well organized civil society groups (unions, agricultural organizations, environmental groups, academic institutions, political parties, religious organizations, among others), part of the academy, and NGOs
- The main complaint of sectors opposing the treaty was that they felt excluded from this process, and that the negotiating texts were not to be disclosed by any of the Central American nations until they were concluded
- Numerous supportive statements and promoting actions in Central America, from exporters, business chambers, government officials, and international organizations, suggest a strong confidence and high expectations towards the ratification and implementation of the agreement

Conclusions - Effects

- The U.S.-Central American Free Trade Agreement (CAFTA) is a step forward in Central America's integration into the international economy of today
- Without CAFTA, it is possible that the region will lose the long-term benefits from improved trade and greater political, social and economic development
- CAFTA on its own might not be able to provide all these benefits, but it is hoped that it will be accompanied by policies that will make possible a favorable economic transformation
- The long-term benefits of the agreement for Central America appear to greatly outweigh the long-term costs. How much the region benefits will depend on how effectively the countries can manage the process of transforming their productive capacity



THANK YOU

