

The United States Central America Free Trade Agreement (CAFTA): Negotiations and Expected Outcomes¹

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Abstract

The U.S.-Central American Free Trade Agreement (CAFTA) is expected to create the conditions for the promotion of a more dynamic export sector in the region, and to build a solid base for a development path in Central America based on increasing foreign direct investments, the creation of productive linkages with local firms and the consolidation of clusters, the transfer of technology and human capital formation, and the reinforcement of integration strategies. The ratification of the agreement will enhance the advances made in Central America with the creation of regulatory frameworks, free trade zones, and incentive schemes to attract more foreign companies.

This study evaluates the main economic, political, and social forces involved in CAFTA negotiations. A political economy approach is used to assess the participation and influence of the main interest groups in Central America, and how their particular interests have been incorporated into the Agreement. Although the process of negotiating a Free Trade Agreement is extensive and participatory, and in general the net impact for a country is expected to be positive, the final balance of interests might favor specific “groups” or “sectors.”

The non-participatory nature of the trade rounds, the strong negotiating position of the United States, the fast paced schedule for negotiation and the limited availability of information regarding negotiated texts were some of the points brought out by opposition groups to sway public opinion against the treaty. On the other hand, there was a strong support and enthusiastic promotion of CAFTA from the dynamic productive sectors of the region. Exporters, prominent businessmen, investors, and, in general, those companies integrated with regional and international markets are seen as major potential winners of the agreement.

Besides the expansion of trade flows, CAFTA builds the foundations for a development path in Central America based on increasing foreign direct investments, the creation of productive linkages with local firms and clusters consolidation, the transfer of technology and human capital formation, and the reinforcement of integration strategies in the region. Significant advances have been made in Central America with the creation of regulatory frameworks and incentives schemes to attract more foreign companies.

Central America can expect broad and lasting benefits from CAFTA if the region can put in place the infrastructure, capital and human endowments, and institutional capacity necessary to participate successfully in world markets. CAFTA establishes a clear direction and powerful “driver” for leaders and policy makers to make much-needed political and financial investments toward truly competitive, successful, and equitable societies.

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1 Introduction

Central America is a strategic region for international trade and investment. Given its geographic position, it is a natural bridge between North and South America, and between the Pacific and Atlantic Oceans. After decades of political and social convulsion, the region has made significant advances with the consolidation of democracy and the recovery of economic growth. The Central American countries are global business players. They are increasingly integrated into world trade and the flow of foreign direct investments. Likewise, there are important changes in their productive sectors towards higher value added activities, an increasingly diversified mix of exports, and more integrated efforts to improve the business climate of the region.

The Central American integration process is being reinforced, with important infrastructure and logistics projects, increasing trade of goods and services, and investments linking countries. At the same time, the region is consolidating the trade openness and liberalization process started almost two decades ago, together with a stronger integration with international markets. This effort includes the pursuit of diverse Free Trade Agreements (FTAs) with several countries in the Americas.

Within this regional scenario, the U.S.-Central American Free Trade Agreement (CAFTA) is expected to create the conditions for the promotion of a more dynamic export sector in the region, and to build a solid base for a development path in Central America based on increasing foreign direct investments, the creation of productive linkages with local firms and the consolidation of clusters, the transfer of technology and human capital formation, and the reinforcement of integration strategies. The ratification of the agreement will build on the advances made in Central America with the creation of regulatory frameworks, free trade zones, and incentive schemes to attract more foreign companies.

The United States and five Central American countries, El Salvador, Guatemala, Honduras, Nicaragua and Costa Rica, concluded negotiations on the CAFTA in December 2003-January 2004.² The agreement was signed on May 2004, and it is expected to be ratified by all countries in 2005.³

Under the U.S. Caribbean Basin Trade Partnership Act (CBTPA)⁴, and the Generalized System of Preferences (GSP), many exports from Central America already enter the United States duty-free. CAFTA will consolidate these benefits and make them permanent, so that nearly 100 per cent of all consumer and industrial products made in Central America will enter the U.S. market duty-free immediately upon ratification of the agreement.

² The Central American Common Market (CACM) includes Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. The same countries have negotiated the U.S.-Central American Free Trade Agreement (CAFTA). The Dominican Republic was included into the Agreement on August 2004, named afterwards DR-CAFTA.

³ The agreement was ratified by El Salvador's Congress on December 17, 2004, and Honduras' Congress on March 2, 2005.

⁴ Enacted in May 2000 as part of the Trade and Development Act. The CBTPA enhanced the 1984 Caribbean Basin Initiative (CBI) benefits.

Products like apparel, bananas, and sugar, will have a better positioning with CAFTA, although important forces outside the region's control influence the international markets for these products. In the case of apparel and textiles, the global liberalization of textile and clothing quotas at the beginning of 2005 under the Agreement on Textiles and Clothing (ATC), will widen the market for Chinese exports, with a significant impact on competition in the U.S. market for Central American products.

CAFTA will liberalize bilateral trade between the United States and the region, and strengthen integration efforts among the countries of Central America, removing barriers to trade and investment in the region by U.S. companies. CAFTA will also require the Central American countries to undertake reforms to improve their performance in critical competitiveness areas, including custom integration and administration, the protection of intellectual property rights, access and protection of investments in utilities, and insurance and financial services markets.

This study evaluates the main economic, political and social forces involved in the CAFTA negotiations. A political economy approach is used to assess the participation and influence of the main interest groups in Central America, and how their particular interests have been incorporated into the Agreement. Although the process of negotiating a Free Trade Agreement is extensive and participatory, and in general the net impact for a country is expected to be positive, the final balance of interests might favor specific "groups" or "sectors." Consequently, the process of negotiation and ratification of the Agreement, and in general the "domestic consensus" to approve CAFTA, and its potential impact, depends on the balance of different economic and political forces.

2 CAFTA and Trade Liberalization in Central America

Perhaps the most meaningful change experienced by Central America in the last fifteen years has to do with the consolidation, increasingly irreversible, of the "openness" of the region. Central America has been deliberate in opening its economies, and has established measures to accelerate it through tariff cuts, privatizations, and the signing of free trade agreements. Globalization is advancing with information and communication technologies, and improvements in logistic systems. The challenge is to create the conditions to take advantage of this sweeping change and to improve the welfare of all Central Americans.

Although three Central American countries suffered civil wars in past decades, and the region has been struck by natural disasters in recent years, Central America has witnessed a period of economic recovery since in the 1990s. The expanding economies are reinforced with democratic governments, offering a positive perspective for the region's future. On average, Central America grew by 3.1 percent in year 2004, with positive growth rates in all countries, notwithstanding the negative effects of the world economic slowdown, and the presence of deteriorating terms of trade in recent years.

The recent growth in regional GDP contrasts with a very modest 1 per cent increase in regional per capita GDP. So far, the economic recovery in the region has not been

strong enough to improve the income conditions of all Central Americans. In addition, there are important disparities between the countries in terms of per capita GDP.

Still, there are potential gains for all from a broader integration into the global economy. All the countries in the region are transforming their economies, currently driven by industry and service sectors growth, but still with an important participation of agriculture. Additionally, by creating new industries and attracting foreign direct investments, Central America's productive structure is experiencing significant diversity in its growth.

The Central American integration process has been reactivated in recent years.⁵ At present, an average of 35 percent of trade is intraregional. The five members of the Central American Common Market (CACM) agreed in 1995 to reduce their common external tariff to a maximum of 15 percent. The region has one of the lowest average tariff rates of the world, as a result of a unilateral process of trade liberalization and a strong commitment to global integration. However, selected agricultural commodities are protected with tariffs that significantly exceed the 15 percent common external tariff ceiling. These specially protected commodities include dairy products, rice, sugar, and poultry.

In keeping with the productive sector's diversification process, the economies of Central America have experienced an important shift in the regional export mix from traditional agricultural goods (coffee, bananas, sugar) and apparel products, to a more diversified mix of exports of fruits and vegetables, electrical machinery, chemical products, medical equipment, and seafood.

Currently, the 15 most important products exported by Central American countries represent 55 percent of the region's total exports, an equivalent figure for only three products (coffee, bananas and sugar) two decades ago. Foreign direct investments have contributed in a decisive manner to this diversity, since most of the export diversification has been influenced by policies and incentives to attract foreign investment.

In 1998, the region witnessed an outstanding inflow of foreign investment, mainly because of the privatization of telecommunication companies in El Salvador and Guatemala, and the significant investments of the multinational company INTEL in Costa Rica. Foreign direct investment continues to grow, and is expected to increase with the ratification of CAFTA. In 2004, the region received more than US\$1 billion in foreign investments.

Although apparel and textile products sectors in Central America traditionally received the most important amounts of FDI, the region has become an attractive option for investors looking to do business in other productive sectors as well. A

⁵ Central American integration first began in 1951, when the Organization of Central American States (ODECA) was founded. The creation of the Central American Common Market, the Central American Bank for Economic Integration (CABEI) and the Secretariat for Central American Economic Integration followed in 1960. In 1973, ODECA was suspended and the integration process stalled. In 1993 a new integration program, the Central American Integration System (SICA), materialized and began a new integration process. The consolidation of a customs union system in Central America, expected in 2005, is seen as a crucial step towards the strengthening of regional integration.

wider range of industries, including electrical equipment, medical devices, software, chemical products, beverages and food preparations, tourism, financial services, call centers, energy and telecommunications, among others, have been growing and attracting significant foreign investment.

During the last decade, trade policy in Central American countries has been based on the pursuance of Free Trade Agreements (FTAs). Currently, Central America has signed FTAs with Canada, Mexico, Chile, Dominican Republic, and Caribbean countries. In addition, investment agreements have been ratified with an important group of countries, European as well as Latin American. Currently, talks have been started to pursue an FTA with the European Union.

CAFTA is seen as a “logical” step forward in the global integration process of Central America, begun almost two decades ago. The agreement will not only consolidate trade and investments with the U.S., but create a business platform in the region, to attract more companies and investors interested in entering the U.S. market. The agreement would also improve the business environment of Central America, with more regional projects in infrastructure and logistics. Most important, there would be a more solid integration of a regional market of 35 million people.

The U.S. exported nearly US\$11 billion in goods to the five Central American countries in 2003, more than U.S. exports to Russia, India and Indonesia combined. Two-way trade was over US\$23 billion in 2003.⁶ CAFTA, plus the Dominican Republic, will create the second largest U.S. export market in Latin America, behind only Mexico. The agreement is clearly significant.

United States is the main trading partner of Central American countries. Almost 50 percent of the region’s international trade (exports and imports) is with the U.S. In addition, the stock of U.S. foreign direct investments in the region is US\$3 billion.⁷ In 2001, the CAFTA countries exported US\$11 billion to the U.S. market. Up to November 2004, the figure was US\$12 billion. Although “traditional” exports like apparel products, bananas and coffee still represent a very important share of regional exports, in recent years there has been a diversification of exports, towards more technologically advanced sectors like electronics and medical instruments, non-traditional agricultural products like fruits and vegetables, beverages and prepared meats, seafood, and chemical products.

Other goods like fruits and vegetables, forestry products, and processed food have growth potential, particularly if higher value is added with further processing, product differentiation, and quality improvements. Growing sectors like electrical equipments and medical devices, and apparel and textiles are foreign investment-led activities, so further improvements in the competitiveness climate of the region should help consolidate and expand investments and trade in these sectors.

3 Why CAFTA? Incentives and Agendas

⁶ USTR (2004).

⁷ According to USTR data.

The birth of a political event is important. Who are the “parents,” who is the “mid-wife,” and who are the “god-parents”? What are the incentives and agendas of each participant? The answers to these questions are not obvious. Understanding the role of all actors is crucial for explaining the terms of the Free Trade Agreement.

In 1994, Mexico gained preferential access to the North American market through NAFTA, and Central American nations began pressing for free-trade talks with the U.S. Given the relatively slow speed at which multilateral trade negotiations were taking place, Central American countries felt the need to engage in regional trade agreements in order to reap perceived benefits from trade, as well as a tactical response to the strategy of other nations. According to Anabel González, CAFTA chief negotiator of Costa Rica, “for more than seven years the region put forward their intentions to negotiate an agreement, but an agreement was not a priority for Bill Clinton’s administration.”⁸

Under President George W. Bush, this issue became more topical and he decided to take the initiative. On January 16, 2002, he announced his intention to explore a free trade agreement with Central America. After signing the Trade Act of 2002 on August 2002, which includes the Trade Promotion Authority (TPA), he formally notified Congress of his intention to negotiate a U.S.-Central America Free Trade Agreement (CAFTA). The TPA was the basis of the new wave of Free Trade Agreements (FTAs) pursued by the U.S. The Bush administration has completed FTAs with 12 countries, and is currently negotiating with 10 other countries.

Robert Zoellick, former U.S. Trade Representative, has been a strong supporter and promoter of Bush’s trade vision, and a CAFTA enthusiast.⁹ In an article in the *Wall Street Journal* he criticized former Democrat candidate John Kerry intentions to abandon the U.S. drive for Free Trade Agreements, arguing that “a president must fight for an open trading system to help American workers, farmers and businesses, as well as to lead the international economy. The Constitution grants authority over trade to the Congress, whose representatives reflect local interests. It takes presidential willpower to look across and beyond individual interests, to build coalitions for openness, and to help people adjust to change.”¹⁰

According to John Murphy, of the U.S. Chamber of Commerce, the rationale for the change in U.S. foreign trade policy was “more geopolitical than directly commercial.”¹¹ Central America is certainly not a vast market for U.S. goods, representing barely over 1 per cent of total U.S. exports. On the whole, the formal deepening of trade relations between Central America and the United States had to do with history, geographic proximity, and economic complementarities. The U.S. needs to make allies of its vulnerable neighbors who are small, poor, vulnerable to natural disasters, and that have also been a source of illegal migrants in recent years. Proponents of CAFTA argue that providing institutional structures will reinforce the

⁸ Interview, October 2004.

⁹ In his new post at the Department of State, he has maintained his supportive position for CAFTA.

¹⁰ *The Wall Street Journal*, October 4, 2004.

¹¹ “How to Trade Up,” *The Economist*, February 13, 2003.

gains made in democracy, the rule of law, and efforts to fight terrorism, organized crime, and drug trafficking.¹²

Additionally, the delay in talks to achieve a Free Trade Area of the Americas (FTAA) reinforced the U.S.' willingness to sign CAFTA. An agreement with Central America, following Chile's FTA, would increase pressure on Brazil to sign an eventual FTAA. These regional agreements would expand support for the U.S. position of building a continental free trade area. It is also hoped that CAFTA will increase the flow of investments towards the region. In addition, the agreement would effectively deepen cooperation and integration between the five Central American countries, decreasing barriers to trade, and finally strengthening the Central American Common Market (CACM).

CAFTA also represents an important "test" of the global challenges faced by trade agreements between rich and poor countries (Hinojosa, 2003). Unlike the previous major wave of regional integration accords in the 1950s and 60s among *similar* countries, the recent wave of regional integration efforts has sought to bring about accords between countries of very different development levels. While the 1960s saw the launching of regional economic integration among the Central American countries, in the 1990s attention began to focus on the possibilities of Central American countries developing a free trade agreement with the largest economy of the world.

A considerable challenge was to achieve a unified negotiating position of the Central American block, despite asymmetries between the different sectors involved. Regina Vargo, U.S. chief negotiator, and John Danilovich, U.S. ambassador to Costa Rica, pointed out that "the main challenge for the region, besides greater integration, is preparing a skilled and highly trained work force."¹³ They believe that the "negotiation process requires economic development, human capital growth and social improvement," which is one of the reasons international bodies have decided to finance projects that will boost the region's development and permit these nations to adapt to an eventual FTA. Some of these organizations include the U.S. Agency for International Development (USAID), the Central American Bank for Economic Integration (BCIE), the Inter-American Development Bank (IADB) and the Organization for American States (OAS).

Many have expressed their reservations about the difference in negotiating capacity between Central America and the United States. Although there were offers from the U.S. and multilateral organizations to assist Central American countries to develop better negotiating skills, this aid was perceived as being self-serving, which required a sensitive approach to the whole negotiation process.¹⁴ Notwithstanding, the experience developed by Central America during the negotiation process of other FTAs was regarded as sufficient to negotiate with the U.S.

Ultimately, the nine CAFTA trade negotiation rounds were concluded swiftly, unifying the interests of various partners that vary significantly from each other. Implementing the agreement will permit the region to create a bilateral agreement to consolidate the unilaterally awarded CBI preferences.

¹² Hornbeck (2004).

¹³ "C.A. ayudará a reducir los costos a EE.UU.," *La Prensa Gráfica*, El Salvador, Feb 3, 2003.

¹⁴ Hornbeck (2004).

Without such an agreement, it is possible that the region will lose the long-term benefits from improved trade and greater political, social and economic development. The trade agreement 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. Unavoidably, there will be adjustment costs that part of the population will have to bear, even with the longer adjustment periods awarded to sensitive sectors. It is not clear whether the long-run welfare gains will be sufficiently apparent to convince “detractors” that the agreement serves the interests of the region.

Most opposition to the agreement has emerged from well organized civil society groups (unions, agricultural organizations, environmental groups, academic institutions, political parties, religious organizations, among others), which are demanding, basically, a better quality of life for the poor and the “forgotten ones” of Central America. Their demands were certainly born before CAFTA. Many of these groups date back to the 1970s and 80s, but remained relatively inactive during the 1990s. When the negotiations of CAFTA were announced, the groups reunited and formed a solid Central American network of social organizations against the agreement.

Even part of the academy has been sympathetic to union leaders and civil society’s arguments against CAFTA. Recently, Albino Vargas, a prominent union leader of Central America, personally submitted a book prepared by a group of intellectuals entitled “101 Reasons against CAFTA” to the U.S. Embassy in Costa Rica. His intention was to convince U.S. officials of the “harmful effects that the agreement will cause to Central Americans.”¹⁵

The ideological background of the civil society groups organized against CAFTA does not differ from the international “mainstream.” Bhagwati (2004) has called it “a trilogy of discontents,” including anti-capitalism, anti-globalization and anti-corporation attitudes. An anti-U.S. sentiment could be added to the list. CAFTA is seen by the major part of its opponents as a new strategy of the vested interests of the United States, and it is commonly argued that “public opinion” is sympathetic to the view of the critics. Interestingly, however, *Latinobarómetro* opinion survey results show that Central American countries are the most “sympathetic” to the U.S. in all of Latin America. When asked about their “opinion” of the United States, 70 percent of responses were positive. In 1996, the answer was 35 percent.¹⁶

In the U.S., CAFTA has faced important opposition as well. Apparel and textile producers, and sugar producers in particular have expressed their discontent with the agreement. This is a logical reaction. According to USITC (2004a), import barriers of textiles and apparel, and sugar, represent respectively US\$12 and US\$1.1 billion in terms of economy-wide welfare transfers, from the U.S. population to these two productive sectors.

Labor unions, especially the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO) and environmental organizations have expressed their

¹⁵ “Costa Rica: sindicatos protestan contra CAFTA,” *El Nuevo Herald*, Miami, Feb 17, 2005.

¹⁶ “Democracy’s low-level equilibrium,” *The Economist*, Aug 14, 2004.

concerns regarding the “race to the bottom” nature of CAFTA because of the weak labor and environmental regulations in Central America. It is argued that labor rights and environmental standards are not only lower in the region, but will worsen with the agreement. Some political observers have even suggested that the agreement will not be sent to the U.S. Congress in 2005.

However, CAFTA is regarded as an advanced agreement in terms of labor rights and the environment. Alberto Trejos, former Minister of Trade of Costa Rica said that “this agreement goes beyond other FTAs, because it ensures strong protection for worker rights and an innovative environmental chapter.”¹⁷ The Office of the United States Trade Representative (USTR) argues that CAFTA even goes beyond Chile and Singapore FTAs to “create a three-part strategy of worker rights that will ensure effective enforcement of domestic labor laws, establish a cooperative program to improve labor laws and enforcement, and build the capacity of Central American nations to monitor and enforce labor rights. It also seeks to develop a robust public submissions process to ensure that views of civil society are appropriately considered, and for the benchmarking of environmental cooperation and the input from international organizations.”¹⁸

This discussion is not isolated. Trade and its related issues will be very important in the legislative agenda of the U.S. in the next two years, with the participation of the U.S. in the World Trade Organization (WTO), the discussion for the extension of the Trade Promotion Authority (TPA) and the ratification of Free Trade Agreements (FTAs), including CAFTA. Traditional protectionist groups in the U.S. will continue their lobbying against free trade initiatives, as U.S. liberalization still is incomplete.

In the case of CAFTA, contrary to other recently FTAs signed by the U.S., the protectionist movement has been particularly active. In words of Alberto Trejos, “CAFTA has faced a very well organized opposition in the U.S. because it affects particular interests of productive sectors and labor organizations.” Notwithstanding, the ratification of the agreement seems likely. In a recent meeting at the Heritage Foundation in Washington DC, Central American Ambassadors to the U.S. indicated that the agreement is expected to be submitted to Congress soon. Representative Kevin Brady, however, argued that the ratification would be “hard but probable.”¹⁹

In the case of Central America, expectations are high because trade is seen as a growth engine. Of course, openness is not a *panacea*, because much else is crucial for growth and poverty reduction. Development depends on institutions, technology, culture and values, among other variables. But, as Krueger and Berg (2002) argue, “the breadth of evidence on openness, growth, and poverty reduction, and the strength of the association between openness and other important determinants of high per capita income, such as the quality of institutions, should give long pause to anyone contemplating the adoption of a novel (or tested and failed) development strategy that does not center on openness to trade.” (p.13)

¹⁷ Interview, October 2004.

¹⁸ USTR (2004).

¹⁹ “Bush y el Congreso se aprestan a batalla por CAFTA,” *El Nuevo Herald*, Miami, Feb 25, 2005.

4 The Negotiation Process: Five Different Stories

Central American policy for more than a decade has moved decidedly toward ever-greater integration into the world economy. While there are still many businesses, political and civil society leaders who oppose trade liberalization and other specific aspects of globalization, there is strong support in all countries for trade and export-led development strategies.

Notwithstanding the expected economic effects of a Free Trade Agreement (FTA), its implementation is a political decision. Thus, it is necessary to understand why a country adopts a particular position in the process of negotiating and ratifying an FTA. There are individuals or groups who attempt to influence the shape of an FTA, including the “demand-side” players (import-competing domestic industries, exporters, labor unions, NGOs), and “supply-side” players responsible for formulating and implementing trade policy (government bureaucrats, politicians and political parties). Every country has a different configuration of political and economic actors.

CAFTA was negotiated, in part, as a regional agreement in which all parties would be subject to “the same set of obligations and commitments,” but with each country defining its own schedules for market access on a bilateral basis. The flexibility of this framework allowed Costa Rica to negotiate longer, and get a slightly different arrangement than the other four Central American countries, each of which also negotiated separate market access schedules.

Each country’s position was first determined at an internal level, establishing the margin for negotiation in each of the different sectors. At a regional level, preparation meetings were held before each round of negotiation, respecting each nation’s limits and establishing a common strategy. Finally, a Central American statement was presented at each trade negotiation round.

Salomón Cohen, first chief negotiator for Guatemala, said at the beginning of the trade rounds that three rules would govern Central America’s negotiating process.²⁰ “Consensus” would force each country to make decisions unanimously between the five nations, “which meant that first they would look into common interest topics.” Secondly, they would form a “solidarity” base, which permitted creating a “regional negotiating platform” that would permit the group to back a country that negotiated a topic that was of special national interest. The third was a “unilateral” principle, whereby any concessions awarded to a Central American partner would immediately be extended to the rest of the group.²¹ 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.

Civil society participation was to take place when each country internally defined its position, but the main complaint of sectors opposing the treaty was that they felt excluded from this process. They claimed that they would nevertheless have to bear the consequences of the negotiations. Later a “side room” was set up to improve the

²⁰ Guatemala changed its chief negotiator three times.

²¹ “Optimismo tras apertura de negociaciones entre EEUU-Centroamérica.” *Agencia Notimex*, Feb 3, 2003.

communication process between those present at the negotiating table and interest groups, but not everyone was able to send its representatives where the rounds were scheduled.

The negotiating texts were not to be disclosed by any of the Central American nations until they were concluded, and the business sector did not approve this measure: “In their country (U.S.) there is a lot of transparency in the freedom of information and the negotiation of treaties, so we do not understand why there are no problems with their private sector having access to the laws being discussed, whereas there are problems when Central America wants to,” expressed Enrique Lacs, director for the Entrepreneurial Commission for International Commerce Negotiations of Guatemala (CENCIT).²²

Sectors who publicly expressed a favorable position towards the free trade agreement did so with caution. Most of them conditioned their approval on having their specific “demands” included in the final text. Rarely were exclusions called for at the beginning of the negotiation, such as, for example, Costa Rica’s petition to exclude the telecommunications sector. In most cases, as expressed by the representatives of these sectors, exclusion would only be an option if their demands ended up bearing no weight in the negotiations.

Many organizations spoke in favor of Central America’s agricultural sector, and believed that the eventual approval of an FTA with the U.S. would need to be accompanied by measures that would guarantee the sector’s survival. Special considerations, in the form of protective tariffs, compensation mechanisms, quotas, or other means would be necessary to prevent the Agreement from having a negative impact on this sensitive sector.

Many of these claims were substantiated in the existence of U.S. subsidies to agricultural goods. Most of them expected more than just an extended tariff phase-out schedule to be able to benefit from CAFTA. Approval would depend on the final results of the negotiation: “We are not against a FTA, as long as we negotiate what is negotiable and our producer’s rights are properly defended,” said a representative of the Central American Agricultural Forum (Foro Agropecuario Centroamericano).²³

Organized groups like the Mesoamerican Initiative for Commerce, Integration, and Sustainable Development, comprised of several farming organizations in Central America, stated that they would like to avoid negotiating tariffs and timelines until the issue of U.S. agricultural subsidies had been discussed in the World Trade Organization (WTO). Secondly, they would like to establish mechanisms that could protect each country’s biodiversity. Thirdly, they proposed establishing compensating mechanisms aimed at subsistence farmers as well as other traditional farmers.²⁴

For most sectors restricting free trade was a necessary condition to approve CAFTA. The rice sector, for example, recommended “only importing the deficit in rice production to protect the local producer, buying only rice in the husk,” according to Michael Hawit Mahchi, from the Central American Rice Federation. The dairy sector

22 *La Prensa Gráfica*, El Salvador, Feb 3, 2003.

23 “Productores del Istmo indefensos ante EEUU.” *El Nuevo Diario*, Nicaragua, Feb 13, 2003.

24 “Campesinos unidos frente al Cafta,” *La Prensa*, Nicaragua, Feb 13, 2003.

also considered that their products should be offered protection. The president from the El Salvador's Dairy and Cattle Industry Association (ASILECHE), Federico Colorado expressed: "We do not want to talk about exclusion, but rather a change in the conditions, because this would open alternative scenarios and would make us less vulnerable."²⁵

On the other hand, there were other parties that saw potential gains from unrestricted trade. Sugar producers, for instance, seemed not to be afraid of competition and were anxious to expand their market share in the U.S. Despite subsidies and internal supports given within the U.S., regional producers believed they had a competitive advantage. They asked for "immediate and unlimited access for Central American exports of sugar, beyond the tariff quota (TRQ-WTO) in the greatest possible degree and for every type of sugar." Also, they sought "unrestricted access to products made from sugar." The sugar that these products contain "should not count towards the quota that the U.S. grants the exporting country." Finally, they wanted to obtain "the greatest possible access for alcohol and ethanol exports, taking into consideration the 7 percent starting point of total consumption that CBI and GSP stipulate." This position was argued by Central American Sugar (Azúcar Centroamericana) and El Salvador's Sugar Association (Asociación Azucarera de El Salvador).²⁶

The poultry sector was especially worried about non-tariff barriers to trade: "We believe commercial reciprocity is vital for free trade because we expect to negotiate real trade flows both ways. (Therefore) the U.S. would have to eliminate sanitary restrictions and technical barriers that are currently in place, and that prevent the entry of poultry products from Central America in that market," according to Agustín Martínez, President of El Salvador's Poultry Association.²⁷ If this agreement was not possible, exclusion would be the only option: "An extreme option to be used only if no agreement is reached that guarantees protection or better market conditions that permit taking advantage of the FTA," said Ricardo Esmahan, executive director of the Agricultural Chamber from El Salvador (CAMAGRO).

Many were openly against the FTA, arguing some agricultural sectors would go bankrupt when competing with U.S. producers who receive government subsidies. For example, rice and pork producers of Guatemala manifested that "If the U.S. wants a FTA, we either want subsidies to end in their products, or we want our governments to start subsidizing our production. We will not be invaded by U.S. products." "We reject the FTA because the U.S. subsidies do not let us compete on equal and just terms in the market they pretend to globalize," and because "it works against our own sovereignty and food-safety" according to the National Council on Agricultural Development (CONADEA)²⁸

25 "Productores leche región pedirán arancel 50 por ciento para EEUU," *Agencia Efe*, El Salvador, Feb 10, 2003.

26 "Intenso cabildeo en Washington. El azúcar pide acceso irrestricto," *El Diario de Hoy*, El Salvador, April 3, 2003.

27 "Estados Unidos quiere vía libre, Avícolas y granos sopesan el TLC." *El Diario de Hoy*, El Salvador, March 24, 2003.

28 "Creativas protestas en Guatemala. Rechazo a subsidios de EE.UU.," *El Diario de Hoy*, El Salvador, Dec 3, 2003.

However, many of these arguments dismiss entirely the potential benefits of liberalization in terms of lower prices and product diversity, particularly for the poor. For instance, Umaña and Figueroa (2002) estimated that the burden of tariff protection in traditional agricultural (sensitive) products for the poorer Costa Rican households (lower 20 percent *quintile*) represented 18 per cent of their real incomes. Although CAFTA might certainly cause negative effects on some productive sectors, this should be balanced with the positive outcomes for the majority of consumers.

Very few studies on the potential effects of CAFTA are available. In the case of Guatemala, Pösner (2003) estimates overall positive results. However, he argues that “some type of intervention is needed to mitigate the potential impact in some rural areas. It is important to design policies that are aimed at soften the impact so that they do not eliminate the positive impact, which is likely to affect the majority of households.” In many ways, the discussion in Central America has been biased against this kind of statements.

In addition, the “negative effects” of the North American Free Trade Agreement (NAFTA) on Mexican agriculture and higher poverty rates are often cited as a clear “example” of how CAFTA will impoverish the region. But contrary to this position, several studies have shown that NAFTA was actually positive for the Mexican farmers. Taylor et al (1999) conclude that aggregate models predicted that Mexico’s agricultural price liberalization would sharply reduce rural employment and incomes and stimulate migration, but these outcomes do not appear to have materialized. The decline in staple production has been relatively small, and it has been concentrated on large commercial farms rather than in the small-farm sector in which more producers are found and from which most migrants originate.

On the other hand, Burfisher et al (2002) found that Mexico could gain from NAFTA only when domestic distortions in agriculture were removed. In that case, agriculture could generate allocative efficiency gains large enough to offset the terms of trade losses that arised because Mexico had higher initial tariffs than its NAFTA partners. Nicita (2004) also found that trade liberalization that occurred between 1989 and 2000 in Mexico has had the direct effect of reducing poverty by about 3 percent, therefore lifting approximately 3 million individuals out of poverty.

Notwithstanding the available evidence, opposition groups have remained inflexible. The non-participatory nature of the trade rounds, the strong negotiating position of the United States, the fast paced schedule for negotiation and the limited availability of information regarding negotiated texts were some of the points brought out by opposition groups to sway public opinion against the treaty. The configuration of opposition groups in each of the five countries varied considerably, but their effectiveness can only be measured when the treaties were sent for ratification in Congress.

Opposition to an FTA with the United States was apparent in the multiple protests organized throughout the negotiating process. These public demonstrations usually had more than one motivation, expressing popular discontent on many topics, not just CAFTA. As a strategy these rallies were held during trade rounds and visits from U.S. representatives to Central America, to attract attention from the media.

Many of these complaints came from union organizations and left-wing political parties across the region, which share a “common” position against CAFTA. For instance, delegates from El Salvador’s FMLN (Frente Farabundo Martí para la Liberación Nacional) spoke of a “harmful FTA” that daunted possibilities to compete because of “a huge economic abyss.”²⁹ Gustavo Porras, secretary general for the National Workers Front (FNT) in Nicaragua argued “the FTA will totally sweep national production.”³⁰ The FNT said CAFTA would “cause job losses and unemployment,” while Guatemala’s National Popular Coordinator for Unions (CNSP) said it would “spur unemployment and misery.”³¹

Civil society leaders were concerned with equity issues, such as the impact on the poor and the distribution of income. Most of their complaints centered on the lack of transparency during the negotiations. José Pinzón pointed that “we have only been informed but we are not part of the agreement.”³² “We are worried about the lack of information, the accelerated rhythm of the negotiations, which prevents discussions from taking place,” explained the leader for the National Foundation for Development (FUNDE) from El Salvador, Hugo López.³³

In general, these groups were suspicious of the “underlying” motives for the United States to negotiate an FTA with Central America. Some went as far as suggesting that the agreement’s real goal was to exploit the region’s natural resources: “We know that they have serious problems with potable water and that is why they want to come and exploit our natural resources” said Carlos Torres, executive secretary from the National Union of Nicaraguan Students (UNEN).³⁴ U.S. bargaining power, argued organized groups who opposed the treaty, prevented the Central American nations from exercising their positions on key issues, like agriculture.

The apparent breakdown of the Central American consensus during the negotiation process worried many sectors. The National Cooperatives Federation in Nicaragua explained that “there exists a great degree of disillusionment and frustration about the process of this negotiation.” It has been confirmed “there is contradictory and superfluous information, and we are very much worried about the mutual accusations between countries, which shows the lack of consensus in the region to negotiate with the United States.”³⁵

This opposition contrasts significantly with the support and enthusiastic promotion of CAFTA from the dynamic productive sectors of the region. Exporters, prominent businessmen, investors, and, in general, those companies integrated with regional and international markets are seen as major potential winners of the agreement. The consolidation of “clear rules of the game” with the biggest market of the world is

29 “Protestan en el Salvador contra TLC Centroamérica-EEUU,” *Hoy*, Dominican Republic, April 3, 2003.

30 “Sindicalistas exponen ante congresistas gringos. FNT: TLC trae desventajas,” *El Nuevo Diario*, Nicaragua, April 24, 2003.

31 “Sindicatos de Guatemala, contra TLC,” *La Prensa*, Panamá, May 5, 2003.

32 “Se oponen a CAFTA,” *Siglo XXI*, Guatemala, April 25, 2003.

33 “Desencanto y frustración. Sociedad Civil: Representantes de la región evalúan terminar acompañamiento a negociaciones con EE.UU.,” *Prensa Libre*, Guatemala, June 6, 2003.

34 “También los universitarios,” *La Prensa*, Nicaragua, Sept 17, 2003.

35 “Desencanto y frustración. Sociedad Civil: Representantes de la región evalúan terminar acompañamiento a negociaciones con EE.UU.,” *Prensa Libre*, Guatemala, June 5, 2003.

expected to foster growth and business development in Central America. In the words of Marco Vinicio Ruiz, regional representative of business chambers for CAFTA negotiations, “the agreement will be an instrument for business growth and internationalization, to create stronger companies, and more and better jobs.”³⁶

The apparel and textile sector believed a strategic alliance with the U.S. producers was the only way to face increasing competition. The sector not only wanted Central America to maintain certain existing preferences (under CBI), but hoped to improve the conditions on existing rules of origin, particularly with the Trade Preference Level (TPL), to be allowed to import fabrics and other apparel inputs from third countries outside the FTA. In the case of Nicaragua, this point was a “key priority,” according to Carlos Sequeira, chief negotiator.³⁷

CAFTA Trade Rounds Summary

Formal negotiations for CAFTA began on January 8, 2003, in Washington DC, with the presence of the Ministers of Trade for each of the countries involved in the negotiations. Since the **first round**, held in Costa Rica the week starting January 27, negotiators were aware that even within each productive sector there was a diverse set of positions among the Central American countries, and one of their main challenges was to unify these criteria.

The chief negotiators, Anabel González, from Costa Rica, Eduardo Ayala from El Salvador, Regina Vargo from the United States, Carlos Sequeira from Nicaragua, Salomón Cohen from Guatemala, and Marvin Redondo from Honduras, said they accomplished their goals in this first week. Although the topics under discussion in this first meeting were public sector purchases, intellectual property, market access, investment services, dispute settlement, institutional arrangements, environment and labor, mostly this meeting served as a process for all negotiating teams to get to know each other.³⁸

Key sectors in Central America wanted to play a part in the negotiating process, but were unclear how this was going to take place, and asked their governments for more information and authorization to participate in the “side rooms,” which served as the mechanism by which the public expressed their opinion at the beginning of the negotiations.³⁹ Some sectors saw opportunities, whereas others expressed their concerns, since they felt unprepared to face such a treaty.

In a press conference, Salomón Cohen, chief negotiator for Guatemala, explained why they were pursuing an FTA with the United States: “It will set clear, stable and long-

³⁶ Interview, November 2004.

³⁷ Interview, November 2004.

³⁸ “Discusiones quedan para otra ronda. Subsidios de EEUU traban el CAFTA,” *El Nuevo Diario*, Nicaragua, Feb 3, 2003.

³⁹ “Gobierno asegura que todavía hay mercado: País no contempla excluir telecomunicaciones de TLC,” *La Prensa Gráfica*, El Salvador, Feb 3, 2003.

lasting rules” for commercial exchange “with the biggest market in the world.”⁴⁰ Furthermore, he argued that the FTA would establish a clear set of rules regarding equity and tariff reduction schedules, so that products would be able to compete, “that is why we are looking for guidelines that will not put us at a disadvantage when opening up to free trade.”

The U.S. ambassador in Costa Rica, John Danilovich was very optimistic about the negotiation process: “You should feel proud about the level of transparency in which this negotiation process is taking place,” and added that “the open and positive attitude of all participants has been evident, especially in this moment when technical aspects are especially relevant.” This view contrasted with the opinion from other sectors that were displeased with the policy of not releasing the negotiated texts until the conclusion of the negotiations.

Positions were submitted at the **second round** for the first time in Cincinnati, Ohio, from February 24 to 28. “The idea of the second round was that each party put forward their position on diverse topics” expressed Anabel González, chief negotiator for Costa Rica.⁴¹ The Central American nations had previously met on February 18 and 19 to formulate their joint proposal, and awaited the U.S. offer.⁴²

Much was said about the balance of power in the negotiation process between Central America and the United States. To Central America’s advantage, it was argued that the U.S. needed to close a negotiation with Central America that would serve as an example for the Free Trade Area of the Americas (FTAA). Also, the final text should be “balanced and sustainable” for all participating nations, because it needed to get approved by Congress in the six countries involved.⁴³

There were also concerns regarding the size of both economies, since Central America represents only about 1 percent of total U.S. exports. Although Central American negotiators hoped that the U.S. would take into consideration the existing asymmetries between the economies, the U.S. proposal disappointed them. Some representatives from the private sector regretted that in the first draft the U.S. left aside the asymmetries (differences) in the economies. Anabel González argued that “in many cases, it does not reflect our interests.” This issue would have to be analyzed in the following round.

The biggest problem for the delegates from the private sector and non-governmental organizations was the level of secrecy.⁴⁴ The various sectors did not know the texts under negotiation and what offers the U.S. government had made to date.

In this round, the U.S. did not address telecommunications, labor rights, or agriculture.⁴⁵ Neither did the U.S. negotiators discuss how to maintain and enforce

⁴⁰ “Optimismo tras apertura de negociaciones entre EEUU-Centroamérica,” *Agencia Notimex*, Feb 3, 2003.

⁴¹ “Negociación termina sin compromisos,” *Prensa Libre*, Guatemala, Feb 3, 2003.

⁴² “Negociadores de nuevo a San José. EE.UU. prepara su propuesta,” *El Diario de Hoy*, El Salvador, Feb 3, 2003.

⁴³ “Segunda ronda terminó ayer: Saltaron primeras chispas en TLC,” *Siglo XXI*, Guatemala, March 3, 2003.

⁴⁴ “A espaldas de los sectores privados de la región. Mucho sigilo en citas sobre libre comercio,” *El Nuevo Diario*, Nicaragua, March 3, 2003.

legislation on competition. This issue was essential for an eventual agreement, as was the case with the Chilean agreement that served as a basis for CAFTA negotiations.

The U.S presented a text regarding phytosanitary measures, rules of origin, textiles, and customs regulations. Progress was also made in the electronic commerce and investment chapters. The U.S. made a proposal for intellectual property rights and government procurement, and suggested solutions to solve conflicts in the dispute settlement process. Finally, they announced the creation of a Small Enterprise Development Center (Centro de Desarrollo para Pequeñas Empresas).

Besides the negotiators and the 200 registered business representatives in Cincinnati, several international organizations came to the meeting, including members from the World Bank, the Inter-American Development Bank, the Economic Commission for Latin America and the Caribbean, and the Organization of American States. On the other hand, only two representatives from civil society were present: Juan Ricardo Fernández and Rubén Fonseca Mora. They were members from consumer advocacy organizations, who came “with a great financial cost,”⁴⁶ representing the Association of Free Consumers (Asociación de Consumidores Libres) and the National Federation of Consumer Associations (Federación Nacional de Asociaciones de Consumidores), both from Costa Rica.⁴⁷

Amidst organizational problems, where some businesspeople could not register and others were left on the street, the **third round** took place between March 31 and April 4 in San Salvador.⁴⁸ Although 900 people were expected, more than 1,500 tried to enter the Princess Hotel, where the event was held. “Slowness or passivity” seemed to pervade the negotiating rooms, since it was argued that no concrete results were achieved. Salvador Urrutia, Minister of Agriculture of El Salvador, said “we are in a warming up stage to enter the real negotiations.”⁴⁹ This round took place amidst protests in the areas near the hotel where the event was held.⁵⁰

Regarding the expectations of this round, the Minister for Industry and Trade of Nicaragua argued that “American negotiators have presented Central America their texts regarding the treaty...how it will develop. But now...concrete topics will be covered, like government procurement, market access, labor and the environment.”⁵¹ The working groups discussed textiles, intellectual property, dispute settlement, investment and services, telecommunications, electronic commerce and agriculture. The tactic was to leave the “hardest” topics for last. For instance, rules of origin were discussed in the last day of the negotiations.⁵²

Carlos Sequeira, chief negotiator for Nicaragua, said that the Central American delegations went to each round with a unified position, where the group would back a

⁴⁵ “Concluye segunda de ronda negociaciones entre EE.UU. y Centroamérica,” *América Economía*, March 3, 2003.

⁴⁶ “Reunión termina con pocos avances. Negociación: Centroamérica conoce mejor posición de EE.UU.,” *Prensa Libre*, Guatemala, March 3, 2003.

⁴⁷ “Insatisfechos con organización,” *Siglo XXI*, Guatemala, March 3, 2003.

⁴⁸ “III Ronda aún sin sorpresas,” *La Prensa / courtesy of El Diario de Hoy*, Nicaragua, April 2, 2003.

⁴⁹ “Cafta avanza a paso lento,” *La Prensa*, Nicaragua, April 2, 2003.

⁵⁰ “III Ronda aún sin sorpresas,” op. cit.

⁵¹ “Cafta avanza a paso lento,” op.cit.

⁵² “III Ronda aún sin sorpresas,” op. cit.

country's position in the topics that most interested them. For instance, agriculture was the most important topic for Nicaragua, since its economy and exports are strong in this area.⁵³ However, the U.S. pointed out that they would maintain the different types of subsidies that they grant their agricultural producers, until the European Union reduces the subsidies granted to these sectors.⁵⁴

During the negotiations, the Minister of Labor of El Salvador, Jorge Nieto, discarded the possibility that the legal framework of each country would be reformed. On the contrary, the U.S. wanted to help improve the existing mechanism, so the labor representatives of Central America prepared a report on regional labor laws and its enforcement in each country.⁵⁵

Regarding market access, Central America asked the U.S. to grant national treatment to all the regional products that enter the U.S. market and to establish rules to simplify the admission of temporal merchandise. The petition also included having clear rules in sanitary and phytosanitary measures. Salvador Urrutia, Minister of Agriculture of El Salvador said that concrete progress had been made in this area, and argued that in CAFTA "international legislation regarding sanitary and phytosanitary measures as stated in the World Trade Organization's regulatory standards" should determine which diseases or plagues can bind or restrict commerce.

The **fourth round** marked the end of a common Central American position on the negotiations. In the meeting held in Guatemala City from May 12-16, Salomón Cohen, chief negotiator for Guatemala, offered immediate duty-free access to 93 percent of the incoming products from the United States. This statement dissolved the Central American consensus and prevented formulating a regional agriculture proposal. The chief negotiator for El Salvador's private sector, Rigoberto Monge, questioned the lack of "progress" in the various texts and the role played by Guatemala: "We took the government's word in the sense that efforts would be made from now on to maintain a regional consensus."

Internally, Guatemala's private sector demanded that their negotiator, Salomón Cohen, reveal the "aggressive" list of products that it presented the United States. "It is easy to speak about percentages, but we do not know what impact they may have, because we would first need to see the proposal," was Armando Beesch's complaint, Vice-President for the Guatemala's Agricultural Chamber. "There are things that concern us, of which we have been informed through the media, which do not respond to the reality of the private sector or the consultations that have been made," added Enrique Lacs, negotiator for the private sector in Guatemala. Among the contentious points were a tariff reduction schedule for cement in five years, and the elimination of tariffs for car imports.

Although drafts for all chapters under negotiation were available in this round, no substantial progress was reached. In part, this was a result of the absence of some of the members of the U.S. team, and Central America's refusal to accept the tariff reduction schedule proposed by the U.S., which ignored all the preferences granted in previous agreements. The Central American Business Council (CECA) considered

⁵³ "Una semana vital, TLC y agro nicaragüense," *La Prensa*, Nicaragua, April 3, 2003.

⁵⁴ "Una semana vital, TLC y agro nicaragüense," *op. cit.*

⁵⁵ "III Ronda aún sin sorpresas," *op. cit.*

that, if accepted, the region would lose millions of dollars and lose previously granted benefits for important exports of the region.

This was a “good but insufficient” offer, according to Eduardo Ayala, chief negotiator for El Salvador, since tariffs would be removed for 70 percent of the goods that the U.S. sends to the region and for 80 percent of the products that Central America exports to the U.S.⁵⁶ This offer did not include the products that already had duty free access according to the preferences awarded by the U.S. in the Caribbean Basin Initiative (CBI) and the General System of Preferences (GSP).

The proposal did not define what types of tariff reductions would prevail for the remainder 30 and 20 percent of goods that were not liberalized. This absence would require Central America to renegotiate all the rights granted through the CBI and GSP, in essence, sensitive products like apparel manufacturing, said Rigoberto Monge, negotiator from the private sector in El Salvador. Central America hoped to get access to the products that had not benefited from the CBI and GSP.⁵⁷

Further disintegration in the Central American negotiating position occurred in the **fifth round** held in Tegucigalpa, Honduras, from June 16-20. Given the outcome of the previous round, there was one Central American proposal and one for Guatemala. “I cannot make backward movements,” said Salomón Cohen, chief negotiator for Guatemala, who received his “main” instruction from the economic advisory committee in Guatemala, “to expedite the process towards free trade.”⁵⁸

The private sector expressed their disapproval towards Guatemala. “This was a setback and a risk for the negotiations because we were looking for multilateral agreements and it shouldn’t be this way,” said Federico Colorado, President of the National Private Sector Association (ANEP). Also, Marco Vinicio Ruiz, private sector representative for Costa Rica, and member of the Central American Business Council (CECA) said that “Guatemala wants to derail the negotiation, risking the whole process and providing evidence that it does not care for Central America’s integration.”⁵⁹

Carlos Sequeira, negotiator for Nicaragua, acknowledged: “We do not have much hope to remain integrated if this persists, but I want to give the minimal amount of courtesy and wait until the last minute of this day.”⁶⁰ Somewhat later, Nicaragua joined Guatemala by accepting a new proposal where immediate free trade would be granted to all products except black beans, rum, beef and pork, and dairy products.

Salomón Cohen and Carlos Sequeira, became the “dissenters” of the region. However, they did not share the same position. Nicaragua had the second greatest number of excluded items in the FTA, with 742 listed in “Category D.”⁶¹ Guatemala, on the other hand, had fewer items to protect. In Category D it included 321 items and used

⁵⁶ “Sector privado salvadoreño critica falta de avance en TLC,” *La Prensa*, Panamá, May 21, 2003.

⁵⁷ “Empresarios rechazan propuesta de EE.UU.,” *El Diario de Hoy*, El Salvador, May 5, 2003.

⁵⁸ “TLC se fragmenta: Guatemala rompe consenso,” *La Prensa Gráfica*, El Salvador, June 11, 2003.

⁵⁹ “TLC se fragmenta: Guatemala rompe consenso,” op. cit.

⁶⁰ “TLC se fragmenta: Guatemala rompe consenso,” op. cit.

⁶¹ Category A= no tariffs; Category B= 5 year tariff phase-out; C= 10 year tariff phase-out; D= excluded goods.

them to get better access to the U.S. market by offering to liberalize them, without consent from the private sector.⁶²

Costa Rica adopted an expected stance. Its negotiators were not willing to wear themselves out or sacrifice their interests because of their neighbors, and threatened to leave the regional negotiation and make their own agreement with the United States, in case that these divisions persisted. Costa Rica was the country most interested in defending its sensitive sectors. El Salvador and Honduras tried to “save” the sixth round of negotiations that was drawing near. Intervention from the Council of Ministers of Trade (COMIECO) was not successful at ending their discrepancies.

During the **sixth round**, as pressure increased to secure results, there was a positive outcome in the negotiations held in New Orleans, from July 28 to August 1, although no concrete agreements were made. The U.S. sought to implement a system of sanctions and fines (a maximum of US\$15 million) for governments that did not comply with their labor or environmental legislation. Central America rejected this proposal and preferred a system that permitted them to strengthen their institutions and Labor Ministries, as well as a dispute settlement mechanism to substitute the sanctions system. Regina Vargo, chief negotiator for the U.S., stated that if fines that guarantee that the labor legislation will be enforced were not included in the agreement, then the U.S. Congress would not ratify it.⁶³

Tying the agreement to labor legislation would create a non-tariff barrier against regional exports towards the U.S., argued The Central American Business Council (CECA). Although it respected labor rights, CECA preferred to handle this topic separately from trade, and suggested that cooperation programs be devised that improve the enforcement of labor laws throughout Central America. Eduardo Ayala said the region could not pay these huge sums.⁶⁴

Recognizing that changes would still need to be made to prepare the region for free trade, Ray Nagin, Louisiana’s mayor, embraced the creation of the Isthmus’ Institute for Commercial Training. Here, Central American governments and firms could find support to prepare their economies for CAFTA. He argued, “The institute can help diminish some of the short-term difficulties that exist in the region and that will appear during the transition process towards an economy based on free trade.” Also, the U.S. decided to invest US\$7 million to help support labor issues, in order to strengthen labor rights and inspections, conflict resolution, and the elimination of child labor.

The U.S. wanted to trade the benefits acquired under the Caribbean Basin Initiative (CBI) in exchange for opening up trade in Central America’s main products.⁶⁵ The U.S. presented Central America a series of “products of interest” that the negotiators had to give an answer to in the following round, including meat, dairy products, vegetables, nutritional products, and cereals, among others.

⁶² “Centroamérica no unifica posturas. Desacuerdos persisten diferencias para el TLC,” *El Diario de Hoy*, El Salvador, May 5, 2003.

⁶³ “TLC: Temas sensibles quedan fuera. Agro y textiles sin consenso mientras se cierra comercio electrónico,” *Prensa Libre*, Guatemala, Aug 4, 2003.

⁶⁴ “Leyes laborales, claves para el TLC,” *El Diario de Hoy*, El Salvador, Aug 5, 2003.

⁶⁵ “Leyes laborales, claves para el TLC,” op. cit.

Some concrete results were achieved. The first two chapters --electronic commerce and customs procedures-- were concluded, and chapters on investment and government procurement were 90 percent complete, according to Claudia Umaña, director of commercial policy for the Ministry of Industry of El Salvador. Also, significant progress was made in the Specific Rules of Origin for agricultural products, and the schedules for tariff reductions were defined for agricultural goods in the FTA. Close to 53 percent of the specific rules of origin were established for the less important agricultural products. In this group, the benefits granted under the Caribbean Basin Initiative (CBI) were consolidated for duty free entry into the U.S. market. The U.S. presented more than 30 agricultural products that it was interested in selling to Central America, without paying tariffs and with fixed schedules for tariff reductions.⁶⁶

Others, like Tatiana Remy from the Textile Quota Commission in Costa Rica were not satisfied with the results. She considered that the *maquila* sector wasted its time, since they wanted to open quotas for the use of fabric from other countries when manufacturing clothing (a mechanism known as TPL) and objections and limitations were raised, although not rejected, by the U.S. negotiators.⁶⁷

For Carlos Sequeira, chief negotiator for Nicaragua, the sixth round was a success: “We got the U.S. to recognize our defense of three agricultural products that are essential to us: rice, beans and corn. At last, there was a tangible manifestation on behalf of the U.S. to recognize this dependence. There are products in which we have a competitive advantage, like sugar and beef.” He added that the FTA could provide Nicaragua with an opportunity to create a stable platform that will attract foreign and domestic investment, and this will generate more jobs. “This is a pressing compromise, since we know how labor conditions are in Nicaragua.”⁶⁸

Central American negotiators were expecting to define the conditions for sensitive products in the **seventh round**, held in Managua, Nicaragua from September 15 to 19. For this reason, agriculture and textiles representatives swamped the hotel halls during the meeting. “I know that many agricultural sectors have found difficult points in the discussions, and there are problems with specific items” said Renzo Céspedes, a business representative from Costa Rica.

Eduardo Ayala, Vice-Minister of Industry of El Salvador, said that they had obtained immediate access to 97 percent of all Central American products that are exported to the U.S. The same would apply to 60 percent of agricultural products: “We only need to reach an agreement concerning the sensitive products.” He explained that one of the factors that hampered progress towards a free trade agreement in the agricultural sector was U.S. subsidies. The United States agreed to eliminate export subsidies for some of its dairy products, in exchange for an agreement that Central America does not purchase these same products from the European Union, which also gives subsidies to its producers in the agricultural sector.⁶⁹

⁶⁶ “VI Ronda superó las expectativas,” *El Diario de Hoy*, El Salvador, Aug 5, 2003.

⁶⁷ “Sin acuerdos para la maquila en el TLC,” *El Diario de Hoy*, El Salvador, Aug 5, 2003.

⁶⁸ “Al término de sexta ronda TLC. Nicaragua en desventaja, reconoce negociador,” *El Nuevo Diario*, Nicaragua, Aug 4, 2003.

⁶⁹ “Negociadores de TLC con EU discuten los temas sensibles,” *La Prensa*, Panama, Aug 27, 2003.

Farmers hoped their negotiators would clarify which products were going to be protected and which ones would have free entry into the U.S. market, but no progress was made. Only one schedule for tariff reductions was established, that protects sensitive products for 15 years. These included dairy products, poultry and pork, sausages, corn and sorghum.⁷⁰ The United States refused to negotiate sanitary and phytosanitary measures in this FTA, since it preferred to do so at the World Trade Organization (WTO) and do the same with agricultural subsidies.⁷¹ The fifteen years requested by the region were granted to sensitive agricultural products.

Negotiators also wanted to discuss the entry of beef into the North American market, as well as the sugar quota that would be approved for the region. They wanted to define quotas for corn and sesame seeds, as well as other products from the poultry sectors, said Carlos Sequeira, chief negotiator for Nicaragua.⁷² Some chapters that were almost concluded included technical obstacles to trade, transparency, and government procurement, and general safeguards.⁷³

The textile sector concentrated on rules of origin, preferential access quotas known as TPAs and scarce supply fabrics, said Fernando Traversari, Vice-President for the Nicaraguan Apparel and Textile Association (ANITEC).⁷⁴ At the end of this round, only some benefits were obtained for the textile and apparel sector in the region, for instance, exporting locally produced clothing without tariffs.

Regina Vargo stated that the legal frameworks for labor and environment in each of the Central American countries were acceptable, and in the case of the United States they would abide by the guidelines set by Congress in the context of the Trade Promotion Authority (TPA).⁷⁵ She expected that the countries in the region support the U.S. in the search for an adequate dismantling of subsidies, which was really an invitation for Costa Rica and Guatemala to abandon the G21 group dominated by Brazil.⁷⁶

The Central American nations were seeking closure in the negotiating process, especially in sensitive areas like agriculture, sugar, pork meat and the dairy sector on the **eighth round** held from October 20 through 24 in Houston, Texas, but many issues were still left unresolved. Negotiators were able to conclude the investment chapter, and defined norms to regulate and promote investment. Definitions for investment, its reach, transfer processes, the liberalization of tax payments for some investment scenarios, and conflict resolution mechanisms were also established. Nicaragua closed the industrial chapter, whereas Guatemala achieved partial results, in the midst of controversy with the rest of the negotiators.⁷⁷

⁷⁰ "Temas difíciles a la zaga en TLC," *La Prensa Gráfica*, El Salvador, Aug 27, 2003.

⁷¹ "Sector no quiere acuerdos aislados en TLC. Agro quiere negociar en bloque," *El Diario de Hoy*, El Salvador, Sep 24, 2003.

⁷² "Nicaragua peleará nuevas cuotas en Cafta," *La Prensa*, Nicaragua, Aug 25, 2003.

⁷³ "Breves del Cafta," *La Prensa*, Nicaragua, Aug 4, 2003.

⁷⁴ "Nicaragua peleará nuevas cuotas en Cafta," op. cit.

⁷⁵ "Cafta se "calentará" en Managua," *La Prensa*, Nicaragua, Aug 4, 2003.

⁷⁶ "Textiles y agro, vencedores de la ronda," *El Diario de Hoy*, El Salvador, Sep 23, 2003. The G21 group was created at the WTO Cancún Ministerial Summit on September 2003.

⁷⁷ "TLC: Productores presionan," *Prensa Libre*, Guatemala, Oct 24, 2003.

Guatemala led the negotiations in agriculture so that this working group “registered some progress.” Agricultural benefits under the Caribbean Basin Initiative (CBI) for ornamental plants, vegetables and tropical fruits were consolidated. With the rest of the agricultural sector, the Central American business sector asked the Presidents and Ministers of Industry of each country to help “accelerate the agricultural negotiation process,” because only one more round of negotiations was left. Representatives blamed the U.S. for not reaching agreements in the whole agricultural sector: “If protection is not achieved at a technical level, let it be done at a political level,” said Benjamín Conrado, a representative for Honduras, who worried that this sector employs more than 20 million people in Central America. The region wanted the following products to be protected: rice, beef, poultry, dairy products, corn, and in Nicaragua’s case only, peanuts.

Central America considered that the U.S. offered a low level of access to the products that most interested the region while they wanted greater openness to their sensitive products. José Madrid, a Costa Rican representative for the Agricultural Federation of Costa Rica (FECAGRO), explained that Central America could not increase the quotas for incoming U.S. products, duty free, as long as a mechanism for the implementation of the Special Agricultural Safeguard was not established.⁷⁸ José Antonio Madrid, another representative of FECARGRO, argued that the U.S. did not permit the entry of “key products for the region” and was not willing to make concessions.

For instance, in the sugar sector, Central American officials stated that the U.S. offered entry only to 15 thousand metric tons, when the region exports, annually, based in a quota agreement with the World Trade Organization, 150 thousand tons. The U.S. offer “was bad because it does not serve our interests or fulfill our expectations,” said Carlos Sequeira, negotiator for Nicaragua.⁷⁹

The dairy sector was seen as one of the most vulnerable groups in the negotiation, but the United States was very interested in having access to its products in the region. The dairy sector in Central American had given the United States an offer, that according to Eric Quiroz, Executive Director for the Central American Dairy Sector Federation (FECALAC), gave exclusive rights to the U.S. to be the sole provider of derived products not produced in the region, like “cheddar” cheese, whey, grinded cheese and other similar products used to produce cookies and corn chips.

Also, they proposed having no tariffs on these products, but to impose a 15 percent tax on imports from other nations that were not from the United States. “We do not stand against greater openness, but this competition is not fair” since most of the North American dairy products are subsidized.⁸⁰ Eric Montero, from the Costa Rican Dairy Producers Chamber said “It is more important to protect the domestic market than to export to the United States.”⁸¹

⁷⁸ “Agricultores se desesperan,” *El Diario de Hoy*, El Salvador, Oct 24, 2003.

⁷⁹ “Tema agrícola estancado en negociación del TLC,” *La Prensa*, Honduras, Oct 24, 2003.

⁸⁰ “EE.UU. quiere apertura total en el sector. Los lácteos, vulnerables al TLC,” *El Diario de Hoy*, El Salvador, Oct 7, 2003.

⁸¹ “EE.UU. quiere apertura total en el sector. Los lácteos, vulnerables al TLC,” op. cit.

Regarding pork, producers were in favor of permitting immediate entry of 100 percent of the prime meat quota, according to Gustavo Mendizábal, from the Guatemala Pork Producers Association. However, the United States demanded opening up the market for all types of meat, without any tariffs that limited trade in the isthmus. Central America argued that if this proposal were accepted, there would be no free trade, since sanitary measures prevented entry of regional products into the North American market.

The Guatemalan delegate, Ramiro Pérez, said that the United States was “cleaning the table” (looking for agreements in other working groups), in order to get to the last round and seek political solutions: “We are convinced that they know the end of the story and we don’t...for us this will end in horror.” Nevertheless, this sector recognized the Central American negotiating effort and pointed to the possibility of rejecting the FTA in parliament, if the United States left no space for a good negotiation.

Costa Rica’s interests were different in many ways. For instance, at the **ninth round** of negotiations, held in Washington DC from December 8 to 12, it seemed that Central America could not sign an FTA as a “whole” region, since Costa Rica was not happy with the results achieved at that date. Alberto Trejos, Minister of Trade, supported this decision by saying that in textiles, agriculture and services, Costa Rica had not obtained the “comfort zone” that the rest of the Central American nations had achieved. But he clarified that they were not trying to be excluded from the process, but “will keep negotiating to be part of the same process, and the idea is that this process will bring us nearer to the United States, as well as to the rest of the Central American nations.”⁸²

Costa Rica’s delay centered on resolving details over how it would open its state-run insurance and telecommunications sectors, 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.⁸³

U.S. negotiators recognized this complication. According to the spokesperson for the Office of the United States Trade Representative, Richard Mills: “Services are important to us, because they represent two thirds of our trade, and that is why there are topics there that still need to be discussed.”⁸⁴ Finally, on the third week of January 2004, Costa Rica signed CAFTA, after five days of negotiations.

5 Winners and Losers, or Players and the Excluded

⁸² “Costa Rica dice no al TLC y volverá a negociar en enero,” *La Prensa Gráfica*, El Salvador, Dec 17, 2003.

⁸³ Hornbeck (2004).

⁸⁴ “Costa Rica dice no al TLC y volverá a negociar en enero,” op. cit.

Central American policy for more than a decade has moved decidedly towards ever-greater integration with the global economy. While there are still many entrepreneurial, political and civil society leaders who oppose trade liberalization and other aspects of globalization, there is strong support across the countries and their political parties for trade and foreign investments-led development strategies. Since 1996, there have been nine changes of government in Central America, and in spite of significant adjustments in other areas of national policy, the commitment to trade and greater global integration has remained intact.

At the private sector level there is strong commitment to free trade in most sectors of the region's economies. A study by Colburn and Sanchez (1999) suggests that during the trade liberalization process in the 1990s, the private sectors in Central America evolved from "protection-seeking" groups to global business players. Although there are strong differences of opinion regarding goals and means, most political sectors across the region maintain a relatively strong pro-trade stance. Colburn and Sanchez (2000) argue that trade and market liberalization in Central America was a "government invention," more than a private sector initiative. In the words of Eduardo Lizano, former president of the Central Bank of Costa Rica "the trade opening process was a policy decision, the companies had to adjust to a stronger international competition environment."⁸⁵

Depending on the final outcome of a Free Trade Agreement (resulting basically from the political bargaining of interest and pressure groups), a group of "winners" and "losers" will emerge. These groups, however, might not be the expected winners and losers, in terms of their success or failure to influence the FTA agreement. Instead, the impact of an FTA will depend significantly on the starting point of an economy, and the particular characteristics of its productive sectors. The ensuing results will then depend on the structure, level of development, stage of competitiveness and dynamics of the different sectors within the economic system of a country.

Less competitive business (or even entire industries) will either have to upgrade to compete, or be forced to move to other activities that offer the opportunity to create wealth. This is the resource reallocation and efficiency gains logic of international trade. If the production capacity and human resources can be upgraded or moved successfully, trade liberalization under CAFTA rapidly would become a success as companies become competitive and workers share in the benefits of growing and thriving businesses. Certainly, Central America stands to gain much by achieving a free trade agreement with the U.S.

However, there are political, economic and social risks that must be recognized and mitigated. Basically, the difficulties lie in the ability of the Central American nations to manage the transformation process. Upgrading competitive capacity and shifting factors of production into other areas is time and resource consuming and requires much investment. Fiscal and institutional constraints in all of the countries of the region limit the ability to invest in many critical areas that would help facilitate and smooth the transformation.

⁸⁵ Interview, November 2004.

At this point in Central America's economic and political development, CAFTA risks becoming a *referendum* on the entire trade integration and "globalization" goals pursued by the region in general. This means that much of the risk is political, relating to ideology and perceptions of who are the "winners" and the "losers."

During the negotiation process, and in the current ratification discussions, CAFTA has been controversial, and faces social and political uncertainty. Generally, those in favor of the agreement hope that CAFTA can be part of a policy foundation supportive of growing trade and investment, and long-term social, political, and economic development. Anabel González, Costa Rica's chief negotiator acknowledges that "Central America is part of an internationally integrated production system whose main axis is the richest economy in the planet, and for this reason the region needs U.S. investment to advance towards increased growth and development. CAFTA will benefit both sides, creating jobs and improving the quality of life of Central Americans."⁸⁶

Numerous supportive statements in Central America suggest a strong confidence and high expectations towards the ratification and implementation of the agreement. For instance, former USAID director in Nicaragua, James Vermillion, indicated that the country needs to ratify CAFTA in order to attract new investments and create new jobs to reduce unemployment.⁸⁷ Antonio Saca, President of El Salvador, was more direct when arguing that "if a country does not export, then it can not develop, and our country's exports depend on the U.S. economy. So the agreement is not only a necessity, is a must."⁸⁸ El Salvador was the first country to ratify the agreement, in a record time.

The "domino effect" is evident. On January 28, 2005, when CAFTA text was sent to the Guatemalan Congress, President Oscar Berger indicated that "it is important to ratify the agreement, because El Salvador already did it, and Honduras will do it soon, and we don't want to miss this good opportunity."⁸⁹ Honduras ratified the agreement on March 2, 2005. Nicaraguan Congressmen are currently discussing it.

On the other hand, there are strong concerns over the potential negative effects of CAFTA on certain Central American productive sectors, workers, small farmers, and other groups. There is compelling evidence that only those poorer countries that have embraced greater openness and closer trade integration with the rest of the world have been able to increase wealth and improve the well being of their populations.⁹⁰ Yet, many in the developing world, including within Central America, view globalization and free trade as yet another mechanism for wealthier countries to control the destiny of poorer ones.

⁸⁶ Interview, October 2004.

⁸⁷ "Cafta generaría más empleo a Nicaragua, según ex director de AID," *La Hora*, Ecuador, Jan 8, 2005.

⁸⁸ *Enlace TBN* broadcasted interview, Dec 20, 2004.

⁸⁹ "Guatemala envió a su Congreso Texto de Acuerdo Comercial con EE.UU.," *La Nación*, Costa Rica, Feb 1, 2005.

⁹⁰ See for example Krueger and Berg (2002), Frankel and Romer (1999). With different statistical techniques, Sala-i-Martin (2002) found that it is incorrect to argue that world poverty and inequality have been rising over the past 30 years, *because of* globalization and free trade. His analysis shows that poverty and income inequality in developing countries has decreased in the last two decades (Africa is the unfortunate exception).

A Free Trade Agreement (FTA) is a type of regional liberalization where tariffs on goods traded among participating countries are removed, but each country keeps its own national trade policy and tariff schedule against non-members. It is typically assumed that trade liberalization resulting from an FTA will cover all tradable goods in the participating countries. However, in reality, there are always so-called “sensitive” activities or sectors that are granted special treatment (safeguards, protection from imported goods, specific schedules for tariff phase-out) when a country forms a Free Trade Agreement.

In this regard, CAFTA is not an exception. 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 almost all goods will attain immediate duty-free treatment, others will 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.

Key Sector Positions

Without undertaking an exhaustive investigation on the position of interested parties, it is useful to summarize some of their views regarding CAFTA.

Agriculture. This is one of the areas of greatest concern for Central America given the subsidies that the United States gives its producers. The U.S. only accepted to review them within the WTO. Given this scenario, diverse protection mechanisms were implemented that sought to obtain the longest possible time periods to reduce tariffs and tried to allocate the minimal amount of products in Category A (full access).

The U.S. chief negotiator, Regina Vargo, stated that the region’s sensitive sectors were protected with tariff phase-out schedules between 12 and 15 years.⁹¹ Also, import quotas were assigned to protect national producers, and these limits were to be determined by national producers.⁹² *Special Agricultural Safeguard (SAS)* were also implemented as protective mechanisms against a possible product invasion from North America. This instrument (SAS) permits a country to raise its tariffs when massive imports threaten local production. Eduardo Ayala, El Salvador’s chief negotiator, explained that it is much more plausible for Central America to apply this safeguard than it is for the U.S., because it is easy for U.S. imports to surpass 10 percent of the regional market, in contrast to the region’s exports exceeding 10 percent of the U.S. market.⁹³

No products were excluded from the agreement. Liberalization will occur through tariff reductions, tariff-rate quota expansion and combination approaches. Each Central American country will have a separate schedule of commitments providing access for U.S. products. The United States will provide the same tariff treatment to each of the five countries, but will make country-specific commitments on tariff-rate

⁹¹ “Estados Unidos asegura que fue flexible: Agro insatisfecho con resultados,” *Siglo XXI*, Guatemala, Sep 22, 2003.

⁹² “Honduras toma fuerza en el TLC,” *La Prensa*, Honduras, Aug 19, 2003.

⁹³ “Nueva propuesta para proteger mercado agrícola,” *La Prensa Gráfica*, El Salvador, Sep 9, 2003.

quotas. Tariffs will be eliminated for all products, except sugar for the United States, fresh potatoes and fresh onions for Costa Rica, and white corn for the other Central American countries.⁹⁴

In order to adapt to a changing environment, the agricultural sector in Central America called for greater investment, since the lack of technology and training, research and development makes this sector vulnerable.⁹⁵ Pratt and Rivera (2003) argue that parallel to trade negotiations and the search for better market-access conditions, the Central American countries should redouble their efforts to continue promoting agricultural competitiveness policies that take advantage of existing comparative advantages, and further advance the creation of competitive advantages based on productivity, product differentiations and high value-added, to create more and better jobs, and new opportunities for Central America's development.

What type of agricultural sector should be created? One that is efficient and competitive at international prices, based on companies' capabilities, with their technical, social and environmental attributes, and in the conditions created by a competitive business climate. Additionally, the use of support instruments that have been successful on a world level, based on the provision of knowledge, infrastructure, the transfer of technology and trade intelligence, should be promoted.

Rice. Establishing a quota for rice imports to Central America was the key to achieving a successful negotiation. This quota would be based on the deficit that currently exists between production and existing consumption.⁹⁶ This sector met with the U.S. counterpart (U.S. Rice Productions) to reach an agreement. More than 15 million people depend on growing this particular grain in Central America, so it was important to ensure their subsistence through a system based on quotas.⁹⁷

Under the agreement, all Central American tariffs will be eliminated in 18 years (20 years for Costa Rica). All tariff cuts will be backloaded, with out-of-quota imports subject to a safeguard. Tariff-rate quotas (TRQs) will be established for rough and milled rice. U.S. tariffs on Central American imports are currently zero. The tariff will be set at zero immediately.⁹⁸

Sugar. This sector was confident that despite U.S. subsidies and internal support, they had a competitive advantage, and asked for "immediate and unlimited access for Central American sugar exports beyond the tariff rate quota level (TRQ-WTO)."⁹⁹ This was one of the sectors that lobbied heavily with the government, the industrial sector, and sugar producers in the U.S. These benefits were restricted to net exporting countries, since the Dominican Republic imports Cuban sugar.¹⁰⁰

⁹⁴ USTR (2004)

⁹⁵ "El gran desafío de los gremios agropecuarios," *La Prensa*, Nicaragua, April 23, 2003.

⁹⁶ "Humo blanco" en arroz," *La Prensa*, Nicaragua, Sep 18, 2003.

⁹⁷ "Arroceros del istmo bajo un solo sombrero," *La Prensa*, Nicaragua, March 3, 2003.

⁹⁸ USTR (2004)

⁹⁹ "De propuestas a propuestas," *La Prensa Gráfica*, El Salvador, March 14, 2003.

¹⁰⁰ "El Salvador sigue en lucha por el azúcar," *La Prensa Gráfica*, El Salvador, Dec 10, 2003. The Dominican Republic was included into CAFTA in August 2004.

The Central American countries will phase out their sugar tariffs over 15 years. The approximately 100 percent out-of-quota duty in the United States will not be cut. The United States will establish TRQs for Central American countries, starting at 97,000 MT and growing to about 140,000 MT in year 15, thereafter growing by 2% a year into perpetuity.¹⁰¹

Pork. This sector lobbied consistently to be excluded from the negotiation, since U.S. competitors receive between 40 and 50 percent of their costs of production in the form of subsidies. On the other hand, Central American producers receive nothing, according to Gustavo Mendizabal, CEO for the Guatemalan Pork Association (APOGUA).¹⁰² This sector eventually accepted a quota for pork meat. According to Vicente Tejada, President of El Salvador's Meat Industry Association (ASICARNE), if the proper mechanisms are created to monitor import quotas, then the local producers should not be affected.¹⁰³ In contrast, sausage producers wanted access to cheaper raw materials, and considered these quotas should not be either small or limited by fixed percentages, since this would affect their competitiveness.¹⁰⁴

Under the agreement, all Central American tariffs will be eliminated by 15 years. Tariffs on bacon and some offal products will be eliminated immediately. TRQs amounting to 9,450 MT will be established and grow from 5 to 15 percent a year. The United States will be allowed to administer exports under the TRQ through an export trading company in four of the countries, if it chooses to do so.¹⁰⁵

Textiles and Apparel. The FTA was seen as an opportunity for Central America to consolidate its market in the U.S. and prevent the Chinese industry from taking its place, expressed Jesús Canahuati, from the Honduran Maquila Association (Asociación de Maquiladores de Honduras).¹⁰⁶ The importance of this sector is evidenced by the half a million direct jobs it generates in the region.¹⁰⁷ Producers hoped that the U.S. would permit the use of Asian textiles in their apparel exports to the U.S., but this was not possible. In the sixth round of negotiations, the U.S. agreed to establish a *yarn-forward* rule of origin. In addition, regional fabrics could enter the U.S. without any tariffs, and use raw materials coming from NAFTA and the Andean Trade Preference Act (ATPA). This sector faced opposition from the cotton producers in the U.S.¹⁰⁸ CAFTA is no panacea, but the textile sector sees it as vital if they are to lower costs, improve competitiveness, attract investment and, in the short term at least, prevent textile jobs from moving to China.

With CAFTA, Textiles and apparel will be duty-free and quota-free immediately if they meet the Agreement's rule of origin, promoting new opportunities for U.S. and Central American fiber, yarn, fabric and apparel manufacturing. The agreement's benefits for textiles and apparel will be retroactive to January 1, 2004. A provision

¹⁰¹ USTR (2004)

¹⁰² "Buscan nuevos mercados," *Siglo XXI*, Guatemala, March 14, 2003.

¹⁰³ "Dilema cárnico en el TLC. En el TLC no será fácil conciliar los intereses de los sectores involucrados con la carne de cerdo," *El Diario de Hoy*, El Salvador, Oct 15, 2003.

¹⁰⁴ "Dilema cárnico en el TLC. En el TLC no será fácil conciliar los intereses de los sectores involucrados con la carne de cerdo," op. cit.

¹⁰⁵ USTR (2004)

¹⁰⁶ "TLC salvaría la maquila centroamericana," *La Prensa*, Panama, May 5, 2003.

¹⁰⁷ "Preocupación por agricultura," *La Prensa Gráfica*, El Salvador, Aug 7, 2003.

¹⁰⁸ "Textileros buscan protección," *La Prensa Gráfica*, El Salvador, Aug 27, 2003.

will give duty-free benefits to some apparel made in Central America that contains certain fabrics from NAFTA partners Mexico and Canada. This provision encourages integration of the North and Central American textile industries, and is a step to prepare for an increasingly competitive global market.¹⁰⁹

Labor. This was one the topics that was left for the last round. Central American leaders were worried that the U.S. would impose penalties if labor laws were not enforced. Governments in the region will have to spend more resources to make sure the current legislation is enforced and to establish control mechanisms. The trade agreement requires countries to enforce their own labor laws, and to “strive to ensure” that those laws uphold international labor standards.

According to U.S. negotiators, enforcing labor regulations was required by Congress to ratify the treaty, but Central American firms saw it as a non-tariff barrier against regional exports to the U.S.¹¹⁰. “In the labor and environment chapters, national legal frameworks should be respected and cooperation programs implemented instead of sanctions,” said Benjamin Bogran, Vice-President of the Private Sector Honduran Council (COHEP).¹¹¹ Another important topic under the labor chapter was labor migration to the United States, and Central America’s effort –particularly El Salvador’s– to guarantee the labor rights of immigrants irrespective of their current visa status.

Telecommunications. The importance of this topic centered on the fact that “the costs of production for firms are tied to the state of telecommunications,” according to Hector Rodriguez, from the Regional Technical Commission on Telecommunications (COMTELCA).¹¹² The telecommunications union, in his view, supported Central America’s competitiveness efforts.

In the case of Costa Rica, this was the only country that initially rejected opening up this sector. In the last round of negotiations it was agreed that private firms could associate with the public monopoly. Alberto Trejos, Minister of Trade of Costa Rica, said that “it would be a selective action, limited to value-added areas, and that openness would be gradual and regulated.”¹¹³ In other words, Costa Rica would have a public firm as a unique provider for telecommunications services and private carriers would only participate in specific areas.

Costa Rica agreed to undertake significant regulatory reforms to open its telecommunications markets. It made specific commitments to gradually open its telecommunications market in three key areas - private network services, Internet services, and wireless services – and committed to establishing a regulatory framework to help foster effective market access. Costa Rica also committed to fully open its insurance market to competition, with the vast majority of the market opening by January 1, 2008, and full opening of the sector by January 1, 2011. The other four

¹⁰⁹ USTR (2004)

¹¹⁰ “Leyes laborales, claves para el TLC,” op. cit.

¹¹¹ “Honduras toma fuerza en el TLC,” op. cit.

¹¹² “Telecomunicaciones, un tema clave,” *La Prensa*, Nicaragua, Nov 14, 2003.

¹¹³ “Costa Rica aceptará abrir las telecomunicaciones,” *El Diario de Hoy*, El Salvador, Dec 3, 2003.

Central American countries also made significant commitments, such as permitting insurance branching within 3-4 years.¹¹⁴

The long-term benefits of CAFTA for Central America appear to greatly outweigh the long-term costs. However, there could be very real political and social risks if CAFTA's benefits accrue too slowly or are seen as only benefiting a minority of Central Americans. CAFTA offers Central America an extraordinary opportunity for improving the well being of its citizens. How much the region benefits will depend on how effectively the countries can manage the process of transforming their productive capacity and addressing the needs of those at risk of being left behind.

6 Potential Impact of CAFTA

It is not easy to estimate the possible impacts of a Free Trade Agreement (FTA). Many factors and conditions are involved. The expected impacts of CAFTA will depend on the growth of employment, trade and investments, on dynamic effects resulting from increased competition within the integrated market, greater investments and technology transfers, and the impact in international relations, including development cooperation, "agreement-pushed" domestic reforms, global reputation, and intra-regional and extra-regional security. The health of the world economy matters, too.

Expected Effects

Quantitative instruments like Computable General Equilibrium (CGE) models have been used to evaluate the likely impact of CAFTA for its member countries.¹¹⁵ The United States International Trade Commission (USITC, 2004b) reports positive but very small economy-wide welfare effects, of less than 0.01 percent of GDP, for the United States. U.S. exports to Central America are likely to increase by US\$2.7 billion or 15 percent, and U.S. imports are likely to grow 12 percent, by US\$2.8 billion after full implementation of the tariff liberalization provisions of the FTA. The impact on U.S. employment and output seems to be minimal. The largest sectoral effects are expected in the textiles and apparel, and sugar industries, both highly-protected activities.

For Central America as a whole, Hilaire and Yang (2004) report an important welfare gain of US\$3.9 billion, or 1.5 percent of GDP, with the full implementation of CAFTA. A main source of the gain for Central American countries comes from expanded sales of textiles and clothing and processed crops, which more than offsets trade diversion from other countries and regions. Total exports from Central America to the U.S. market are likely to increase by 50 percent from their 2002 value, according to the model simulations.¹¹⁶

¹¹⁴ USTR (2004)

¹¹⁵ See for instance USITC (2004), Brown et al (2004), Hilaire and Yang (2004). Because of differences in model specifications, data bases, and country aggregations, the results of these studies show differences in magnitude, but similar "signs" and "directions" of likely effects.

¹¹⁶ This result must be interpreted with caution. The authors use a data base for year 1997, and some recent preferential agreements are not considered, so the growth of textiles and apparel exports are overestimated.

On the other hand, Brown et al. (2004) report a total improvement in U.S. economic welfare of US\$17.3 billion, which is 0.17 percent of GNP, as a result from CAFTA. Economic welfare in Central America increases by US\$5.3 billion, which is 4.4 percent of GNP. For Central America, there are sizable percentage increases in the exports of food, beverages and tobacco, textiles, wearing apparel, leather products and footwear, and services. Total export value increases by US\$8.3 billion.

The likely impact on output in textiles, wearing apparel, and leather products and footwear in Central America is also significant. As a result, the authors estimate that employment increases by 53,741 workers in textiles, 230,663 workers in wearing apparel, and 9,518 workers in leather products and footwear. The percentage increases in employment in these sectors are 28, 42, and 15 percent, respectively. These employment reallocations are apparently quite substantial and suggest that the Agreement may result in significant worker displacement in the process of adjustment brought about by elimination of the import barriers.¹¹⁷

In sum, as a result from CAFTA there would be a welfare improvement for Central American countries, with higher household income levels as a result of lower import prices, and perhaps higher wages. Changes in GDP would not be significant, and trade flows (exports and imports) will grow. A large percentage increases in imports from the U.S. is expected, reflecting the asymmetry between the significantly higher rates of protection in Central America as compared to the United States.

The global liberalization of textile and clothing quotas at the beginning of 2005 under the Agreement on Textiles and Clothing (ATC) will open the U.S. market for Chinese exports, with a significant impact on competition for Central American products. Condo et al (2004) show that, notwithstanding the strong competition from China, Central America still can compete in U.S. apparel markets, especially if higher value is added to the products, and market niches are developed. However, the region should diversify its exports and think on new productive sectors to develop. The probability of achieving sustained economic growth is lower when an economy is less diversified.¹¹⁸

The trade agreement entails large opportunities and threats to the region. Chinese competition highlights the importance of implementing policies aimed at diversifying exports and increasing agricultural production, which can reduce the high unemployment and poverty rates of the region. On the other hand, the main achievement of the CAFTA is the formalization of market access concessions currently set by the U.S. on a unilateral basis under the CBTPA, and the institutional and legal framework that has been negotiated to ease FDI flows to the region. Thus, the potential increase in FDI is expected to stimulate growth and employment opportunities.

Even with the tariff protection on sensitive agricultural products for 15 more years, the effect on these sectors might not be significant. The central problem remains at the local level, because of the low competitiveness of Central America's agriculture. The

¹¹⁷ Brown et al (2004).

¹¹⁸ World Bank (2003)

real, long-term exit to agricultural problems depends on the reorientation of public policies, business strategies, and interrelations between the private, public, civil and multilateral sectors, given that the region has been left behind by the great advances experienced in modern agro-industrial systems worldwide.

The Need to Improve Competitiveness in Central America

In order to take full advantage of CAFTA, the greatest challenge for the region is to improve its productivity and competitiveness. According to Porter (2004), stable political, legal, and social institutions and sound macroeconomic policies create the potential for improving national prosperity. But wealth is actually created at the microeconomic level—in the ability of firms to create valuable goods and services using efficient methods. Only in this way can a nation support high wages and the attractive returns to capital necessary to support sustained investment and investment-led development.

Firms have the ability to increase value and productivity through innovation, new technologies, industry know-how, the offering of unique and valuable products and services, high levels of investment and commitment to continuous improvement, an ability to operate using efficient methods and factor inputs and the advantage of working in a dynamic business sector that seeks long-term competitive advantage. Therefore, the competitiveness of a nation is really built upon the productivity, or competitiveness, of the leading firms and industries within the economy.¹¹⁹

The ability of firms to make productivity gains (the basis of competitiveness) rest on two interrelated areas: (1) the sophistication with which domestic companies or foreign subsidiaries operating in the country compete, and (2) the quality of the microeconomic business environment (frequently referred to as either “business climate” or “enabling environment”) in which they operate. A sound macroeconomic, political, legal, and social context creates the potential for competitiveness, but is not sufficient. Competitiveness ultimately depends on improving the microeconomic capability of the economy and the sophistication of local competitive capacity.

The sophistication and productivity of companies are inextricably intertwined with the quality of the national business climate. The term “business climate” refers to the large set of conditions in a country that determine its potential for successfully fostering economic growth. Traditional determinants of a sound business climate include: the level of macroeconomic and political stability, quality and quantity of necessary physical infrastructure (roads, ports, and telecommunications), cost and ease of doing business with the government, availability of necessary supporting services, quality of human resources, capacity of the legal system, limitations on capital flows, and many others variables.¹²⁰

¹¹⁹ Porter (2004).

¹²⁰ Porter (2004). Competitiveness analysis and discussion is not new in Central America. Since mid-1990s, INCAE has advised the region’s governments and private sectors to embrace the concept of competitiveness into national and regional agendas. Indeed, most countries have started their own competitiveness programs with formal agendas, such as the National Competitiveness Program in Guatemala, the Honduran National Competitiveness Plan, and the National Council for Competitiveness in Costa Rica.

Notwithstanding the national and regional achievements in terms of competitiveness, there is still significant work to do. Central America has a firm conviction that macroeconomic stability is necessary for economic growth and development, as seen in its efforts to control fiscal imbalances, and inflation. However, the region has not been fully integrated into the world economy, and exhibits a deficient level of technological and institutional development, which prevents it from benefiting from global developments and improving its level of competitiveness.

Central American countries need to focus on their current level of public debt, the marked contraction of credit to the private sector and the resulting crowding out of investment. Besides fiscal reform and more control over public expenditure, labor market reforms must be implemented to reduce rigidities, together with reforms in the regulatory, judicial, and political system. According to Mario Blejer, from the Bank of England, “Latin America is falling behind, not only with respect to the economies of East Asia but, more significantly, with respect to the transition economies of Central and Eastern Europe, where reforms have been introduced only recently.”¹²¹ Central America faces this important challenge as well.

The region’s recovery has been encouraged by growth in the world economy, recent improvements in the terms of trade, low international rates of interest as well as lower spreads, and increases in capital flows. This scenario, however, could be put at risk with uncertainties in the international environment. These vulnerabilities include possible changes in the level of interest rates, oil prices, and the evolution of Asian economies, particularly China and its effect on the price of commodities.¹²²

The results of the Growth Competitiveness Index (GCI) show that Central American countries have a lot of work to do in order to enhance their growth potential in the medium and long term. In the macroeconomic environment, Central America still faces some problems that limit its potential for growth. In Costa Rica, the fiscal deficits create pressure on economic stability, one of the main reasons for its higher inflation rates. In Honduras, exchange rate policies are weakening export competitiveness. On the other hand, El Salvador has improved substantially its economic performance through an implementation of a clear and sustainable economic policy, with low inflation and limited state intervention. Guatemala is making an effort to control its fiscal deficit.

Costa Rica and El Salvador are highlighted as the countries in Central America with the greatest growth potential from improvements generated by technological transfer from foreign direct investments and the upgrading of communication technologies. In general, according to the World Economic Forum (2004b), the region presents a diverse picture of potential to improve economic growth.

Interestingly, the region lags behind the majority of its global competitors for trade and foreign direct investment (FDI) attraction, not only in Latin America (Chile), but also in Europe (Ireland) and Asia, particularly in China. The Chinese economy is more stable than Central America’s economy, and it is advancing quickly through with institutional and technology reforms.

¹²¹ Blejer (2004).

¹²² Blejer (2004).

CENTRAL AMERICA: GROWTH COMPETITIVENESS RANKING 2004 –2005*

Country	Growth Competitiveness Index Rank		Technology Index Rank		Public Institutions Index Rank		Macroeconomic Stability Index Rank	
	2003	2004	2003	2004	2003	2004	2003	2004
Finland	1	1	3	3	3	3	3	3
United States	2	2	1	1	21	21	15	15
Singapore	7	7	11	11	10	10	1	1
Chile	22	22	32	32	20	20	27	27
Ireland	30	30	37	37	17	17	21	21
Czech Republic	40	40	19	19	51	51	41	41
China	46	46	62	62	55	55	24	24
Costa Rica	50	50	55	55	47	47	64	64
El Salvador	53	53	69	69	46	46	53	53
Guatemala	80	80	79	79	84	84	79	79
Nicaragua	95	95	96	96	81	81	97	97
Honduras	97	97	93	93	100	100	82	82

*In a sample of 104 countries

Source: World Economic Forum (2004b)

To face these challenges, reforms must be implemented. However, in some of the countries, the concept of structural reform has been discredited and systematically maligned. Although some of these proposed reforms may result in substantial short term costs for a relatively small number of people, they could also improve the conditions for the majority of the population in the longer run. However, interest groups have created a difficult environment to implement these “second generation” reforms. Central America faces a difficult task in its effort to enhance its competitive position, but is certainly progressing from its troubled the past.

Costa Rica has a relatively better business climate and, perhaps not surprisingly, a set of firms pursuing more sophisticated activities than found elsewhere in Central America. However, the results of the Business Competitiveness Index (BCI) indicate that this position is fragile. More work is needed in order to improve the quality of the national business climate, and more efforts from the companies to be more productive. The rest of Central American countries are lagging behind, and their rankings have worsened in the last year. As a result, global competitors are better positioned to enhance their competitiveness.

Costa Rica’s competitive advantages include the impact of FDI on technology transfer, the prevalence of environmental marketing as a business advantage, the cooperation in labor-employer relations, and the quality of the educational system and management schools. As a competitive disadvantage, Costa Rica has a poor development of infrastructure and poor effectiveness of law making bodies.

CENTRAL AMERICA: BUSINESS COMPETITIVENESS RANKING 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
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

El Salvador's competitive advantages include the relatively open access to credit, the flexibility of wage determination in the labor market, and good telecommunications infrastructure. The efficiency of the tax system, and flexible hiring and firing practices are also important competitive advantages. However, there is room to improve in research and development spending, university-industry cooperation in research, reducing the business costs of crime and violence, and augmenting the national savings rate.

Guatemala is suffering from the pervasiveness of money laundering and organized crime, as well as the high business cost of crime and violence. These costs are also high in Honduras, which has problems with irregular payments in public utilities and judicial decisions, as well as favoritism in the decisions of government officials. Nicaragua is ranked last on judicial independence, has a low national savings rate, and is not very transparent in government policy-making.

MAIN COMPETITIVE ADVANTAGES 2004 –2005*

Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	China
FDI and technology transfer	Access to credit	Reliability of police services	National savings rate	Ease of hiring foreign labor	National savings rate
Cooperation in labor-employer relations	Flexibility of wage determination	Hiring and firing practices	Port infrastructure quality	Flexibility of wage determination	Local availability of process machinery
Prevalence of environmental marketing	Efficiency of the tax system	Availability of mobile or cellular phones	Ease of hiring foreign labor	Freedom of the press	Local availability of components and parts
Quality of the educational system	Hiring and firing practices	Freedom of the press	Real effective exchange rate	Hiring and firing practices	University/industry research collaboration
Freedom of the press	Telephone/fax infrastructure quality	Extent of bureaucratic red tape	Maternity laws' impact on hiring women	Business impact of rules on FDI	Pay and productivity

*In a sample of 104 countries

Source: World Economic Forum (2004b)

MAIN COMPETITIVE DISADVANTAGES 2004 –2005*

Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	China
Quality of competition in the ISP sector	University/industry research collaboration	Organized crime	Business costs of crime and violence	Judicial independence	Freedom of the press
Availability of mobile or cellular telephones	Subsidies and tax credits for firm-level research	Business costs of crime and violence	Irregular payments in judicial	Transparency of government policymaking	Soundness of banks

	and development		decisions		
Interest rate spread	Business costs of crime and violence	Pervasiveness of money laundering through non-bank channels	Policy consequences of legal political donations	National savings rate	Business costs of irregular payments
Effectiveness of law-making bodies	Effectiveness of law making bodies	Diversion of public funds	Favoritism in decisions of government officials	Effectiveness of law-making bodies	Extent of bureaucratic red tape
Railroad infrastructure development	National savings rate	Business impact of domestic trade barriers	Irregular payments in public utilities	Prevalence of foreign technology licensing	Availability of mobile or cellular telephones

*In a sample of 104 countries

Source: World Economic Forum (2004b)

When compared to China, the main competitive advantages of Central American countries are in the willingness and ability to absorb new technology, and the freedom of the press, whereas China has very competitive pay and productivity levels, and strong research collaboration between universities and industries. In addition, some of the region's strengths are related to the factor of production markets, which show signs of improvement in recent years. Proximity to the biggest economy of the world is also a competitive advantage for Central America.

There is still considerable work to do in Central America, but positive signals are emerging. One of the most important expected effects of CAFTA on Central America will be the "agreement-pushed" reforms and policy changes that would create a better investment climate for U.S. companies, and at the same time generate positive externalities for other foreign firms interested on investing in the region.

Goods like fruits and vegetables, forestry products, and processed food have growth potential, particularly if higher value is added with further processing, product differentiation, and quality improvements. Growing sectors like electrical equipments and medical devices, and apparel and textiles are foreign investment-led activities, so further improvements in the competitiveness climate of the region should help consolidate and expand investments and trade in these sectors.

Besides the expansion of trade flows, CAFTA builds the foundations for a development path in Central America based on increasing foreign direct investments, the creation of productive linkages with local firms and clusters consolidation, the transfer of technology and human capital formation, and the reinforcement of integration strategies in the region. Significant advances have been made in Central America with the creation of regulatory frameworks and incentives schemes to attract more foreign companies.

Several important regional projects to modernize key infrastructure sectors offer a very optimistic view for the strengthening of the business climate. Among others, the Plan Puebla-Panama initiative supported by the Inter-American Development Bank is promoting a US\$3.5 billion investment to improve highway infrastructure in Central America, with Pacific and Atlantic corridors and a modern network of interconnection. The completion of the electrical grid interconnection in Central America is another

important project that will optimize the generation and distribution of electricity across the region. Further market liberalization and foreign participation will reinforce these initiatives.

The region is also experiencing an important development of the telecommunications sector. New technologies are being introduced, with a broad participation of foreign firms like Bell South and France Telecom, with more and better Internet service providers, and the construction of two regional optic fiber networks. Additionally, the financial sector is growing and integrating its operations within Central America, with modern regulatory frameworks, advanced technology, highly dollarized economies, and the development of capital markets.

There are also important efforts in each country to improve ports and airports, and to coordinate regional customs modernization and harmonization. All these efforts, together with the expanding logistics, transport and distribution services, present a very promising outlook for Central America as a future investment and trade platform for the Americas and the rest of the world. Leading global companies like Intel, Siemens, Hydro Quebec, AT&T, Maersk-SeaLand, Procter & Gamble, Holcim, Sakata Seed, among others, are investing on leading sectors and placing their Latin American headquarters in the region, an optimistic signal for the future of business and economic growth. CAFTA will contribute to this process of development, attracting the necessary investments to increase productivity in Central American countries, and consolidate the development of a regional market of significant scale.

7 Conclusion

Central America is a strategic region for international trade and investment. Because of its geographic position, it is a natural bridge between North and South America, and between the Pacific and the Atlantic Oceans. After decades of political and social convulsion, the region has made significant advances with the consolidation of democracy and the recovery of economic growth. The Central American countries are now global business players; more integrated with world trade and foreign direct investments flows, with important changes in their productive sectors towards higher value added, an increasingly diversified set of exports, and a more integrated effort to improve the business climate of the region.

Central American integration is being reinforced with important infrastructure and logistics projects, increased trade of goods and services, and investments bridging the countries. At the same time, the region is consolidating the “openness” and liberalization process begun almost two decades ago, together with the closer integration of international markets, through the current negotiations of free trade agreements with several countries in the Americas. Together with Panama, the five Central American countries are creating a regional business platform.

The U.S.-Central American Free Trade Agreement (CAFTA) is a step forward in Central America’s integration into the international economy of today. It is not the first step, but it is a historic and transcendental step. Understanding well how the trade agreement was negotiated provides valuable clues into how the economics of the countries of the region are likely to evolve.

For several years the region put forward their intentions to negotiate a Free Trade Agreement with the U.S., but it was not after the signing of the Trade Act of 2002, which includes the Trade Promotion Authority (TPA), that CAFTA became an issue. United States is the main trading partner of Central American countries. Almost 50 percent of the region’s international trade (exports and imports) is with the U.S. In addition, the stock of U.S. foreign direct investments in the region is significant

Under the Caribbean Basin Initiative (CBI) many Central American products enter without duties to the U.S. CAFTA will formalize these trade concessions. Products like apparel, bananas, and sugar, will have a better positioning with CAFTA. Without such an agreement, it is possible that the region will lose the long-term benefits from improved trade and greater political, social and economic development. The trade agreement 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.

In Central America, 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 ideological background of the civil society groups organized against CAFTA does not differ from the international “mainstream” against globalization.

Civil society participation took place when each country internally defined its position, but 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. In general, these groups were suspicious of the “underlying” motives for the United States to negotiate an FTA with Central America.

On the other hand, 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. Generally, those in favor of the agreement hope that CAFTA can be part of a policy foundation supportive of growing trade and investment, and long-term social, political, and economic development.

CAFTA was negotiated, in part, as a regional agreement in which all parties would be subject to “the same set of obligations and commitments,” but with each country defining its own schedules for market access on a bilateral basis. At a regional level, preparation meetings were held before each round of negotiation, respecting each nation’s limits and establishing a common strategy. Finally, a Central American statement was presented at each trade negotiation round. However, 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.

After nine rounds of negotiation, plus an additional round between Costa Rica and the U.S., CAFTA was signed. 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.

The state of competitiveness in the region is moderate, with improvements in some areas of macroeconomic management, better public institutions and regulatory systems, and an increasing but still limited level of technological sophistication. The recently started work of national competitiveness boards is expected to have positive results in the medium term, to create better conditions for productivity and business growth performance in each nation. In the regional agenda, priority goals include the attraction of productive investments, the promotion of high value added exports, the modernization of infrastructure, integrating customs, and the strengthening of environmental and natural resources management.

Within this scenario, there are investment opportunities for local and foreign investors: utilities, infrastructure and logistics markets, consolidated and emerging high value-added exporting sectors, with productive linkages with national companies, and with more exports of goods, technology and knowledge from foreigners to Central America, and from the region to the diverse preferential-access markets open for Central American products in the U.S. market. In addition, the operations of foreign firms in the region would create a solid base for future integration initiatives with the European Union and Asian economies.

Central America can expect broad and lasting benefits from CAFTA if it can put in place the infrastructure, capital and human endowments, and institutional capacity necessary to participate successfully in world markets. CAFTA establishes a clear direction and powerful “driver” for leaders and policy makers to make much-needed political and financial investments toward truly competitive, successful, and equitable societies.

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Appendix A Main Economic Indicators of Central America

Growth Rates	1995	1996	1997	1998	1999	2000	2001	2002	2003
Gross Domestic Product									
Costa Rica	3,9	0,9	5,6	8,4	8,2	2,2	0,9	2,6	5,6
El Salvador	6,4	1,7	4,2	3,7	3,4	2,2	1,7	2,1	2,0
Guatemala	4,9	3,0	4,4	5,0	3,8	3,6	2,3	2,2	2,1
Honduras	4,1	3,6	5,0	2,9	-1,9	5,7	2,6	2,7	3,2
Nicaragua	5,9	6,3	4,0	3,7	7,0	4,2	3,0	1,0	2,3
Average	5,1	3,1	4,6	4,8	4,1	3,6	2,1	2,1	3,0
Exports of Goods									
Costa Rica	11,1	6,2	8,6	26,7	21,3	-1,6	-6,7	1,9	11,1
El Salvador	13,9	8,7	30,2	6,2	7,1	16,8	-0,4	5,7	4,9
Guatemala	12,6	8,7	8,1	2,4	4,6	3,8	-4,0	-6,7	4,6
Honduras	13,6	8,1	1,3	1,6	-11,2	7,3	3,2	4,9	5,2
Nicaragua	22,1	16,2	14,4	5,8	12,3	12,5	8,7	-3,3	0,2
Average	14,6	9,6	12,5	8,5	6,8	7,8	0,2	0,5	5,2
Imports of Goods									
Costa Rica	2,9	2,7	14,7	25,2	0,4	-3,1	0,2	7,8	2,3
El Salvador	21,1	-6,1	16,8	9,2	2,7	14,5	4,4	0,5	5,4
Guatemala	7,6	-6,9	19,5	24,5	0,7	6,0	6,9	6,6	0,6
Honduras	4,0	2,4	-1,4	7,5	4,3	3,8	4,0	2,5	9,0
Nicaragua	14,1	12,9	22,1	7,2	20,7	-5,3	0,2	-0,5	-2,3
Average	9,9	1,0	14,4	14,7	5,7	3,2	3,1	3,4	3,0
Real Per Capita GDP									
Costa Rica	1,3	-1,6	3,1	5,9	5,8	-0,1	-1,2	0,6	3,6
El Salvador	4,2	-0,4	2,1	1,6	1,4	0,2	-0,2	0,2	0,1
Guatemala	2,2	0,3	1,6	2,3	1,1	0,9	-0,3	-0,4	-0,5
Honduras	0,7	0,3	1,6	-0,4	-5,0	2,3	-0,7	-0,6	-0,1
Nicaragua	2,9	3,5	1,2	0,9	4,2	1,4	0,3	-1,6	-0,4
Average	2,2	0,4	1,9	2,1	1,5	1,0	-0,4	-0,4	0,5
Inflation Rate									
Costa Rica	22,6	13,8	11,2	12,3	10,1	10,2	11,0	9,7	9,9
El Salvador	11,3	7,4	1,9	4,2	-1,0	4,3	1,4	2,8	2,5
Guatemala	8,6	10,9	7,1	7,5	4,9	5,1	8,9	6,3	5,9
Honduras	26,8	25,3	12,8	15,7	10,9	10,1	8,8	8,1	6,8
Nicaragua	11,1	12,1	7,2	18,5	7,2	9,9	4,6	4,0	6,5
Average	16,1	13,9	8,1	11,6	6,4	7,9	6,9	6,2	6,3

n.a.= not available

Source: Own elaboration with data from Central Banks

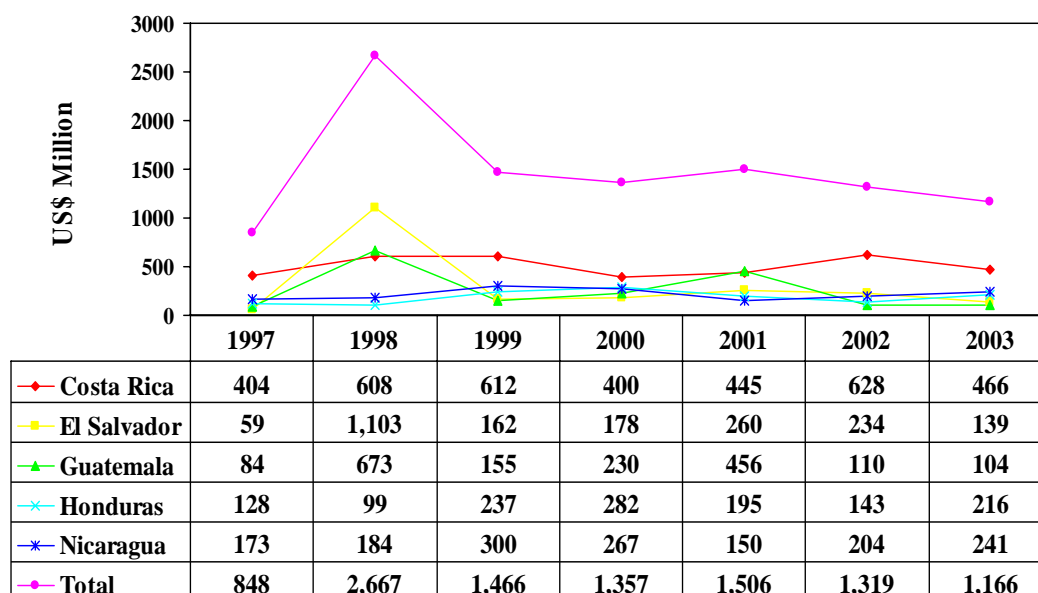
International Trade of Central America

Country	Exports of Goods			Imports of Goods			Trade Balance		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
Costa Rica	4,923	5,259	6,051	5,744	6,523	7,086	-821	-1,263	-1,035
El Salvador	2,891	3,017	3,208	4,796	4,922	5,405	-1,905	-1,906	-2,197

Guatemala	2,860	2,629	2,789	5,142	5,578	5,712	-2,282	-2,950	-2,923
Honduras	1,943	1,930	2,052	2,807	2,804	3,167	-865	-874	-1,115
Nicaragua	723	721	731	1,620	1,636	1,624	-897	-916	-893

Source: ECLAC (2004)

FDI inflows in Central America



Source: ECLAC

Human Capital in Central America

Country	Health Expenditure per capita US\$ PPP	Adult Literacy Rate (% Age 15 and above)	Students in Science, Math and Engineering (% of Tertiary Students)	Scientists and Engineers in R&D (Per million people)	Public Expenditure on Education (% of GDP)	Human Development Rank ^a
	2000	2001	1994-97	1996-2000	1998-2000	2001
Costa Rica	474	95.7	18	533	4.4	42
El Salvador	391	79.2	20	47	2.3	105
Guatemala	192	73.4	n.a.	103	1.7	119
Honduras	165	75.6	26	n.a.	4.0	115
Nicaragua	108	66.8	31	73	5.0	121

a. Human Development Index ranks 175 countries

Source: UNDP (2003)

Main Imports of United States from Central American Countries

	CIF Value 2003 US\$ Million	Growth 2002-2003	Growth Potential
Total Imports from Central America	13,065	5 %	Medium-High
Costa Rica			
Total Imports	3,574	7 %	
Electrical Machinery and Equipment	821	31 %	High
Bananas and Other Fruits	650	10 %	High
Articles of Apparel and Clothing	603	-19 %	Low-Medium
Medical Instruments	485	31 %	High
Coffee	131	4 %	Low-Medium

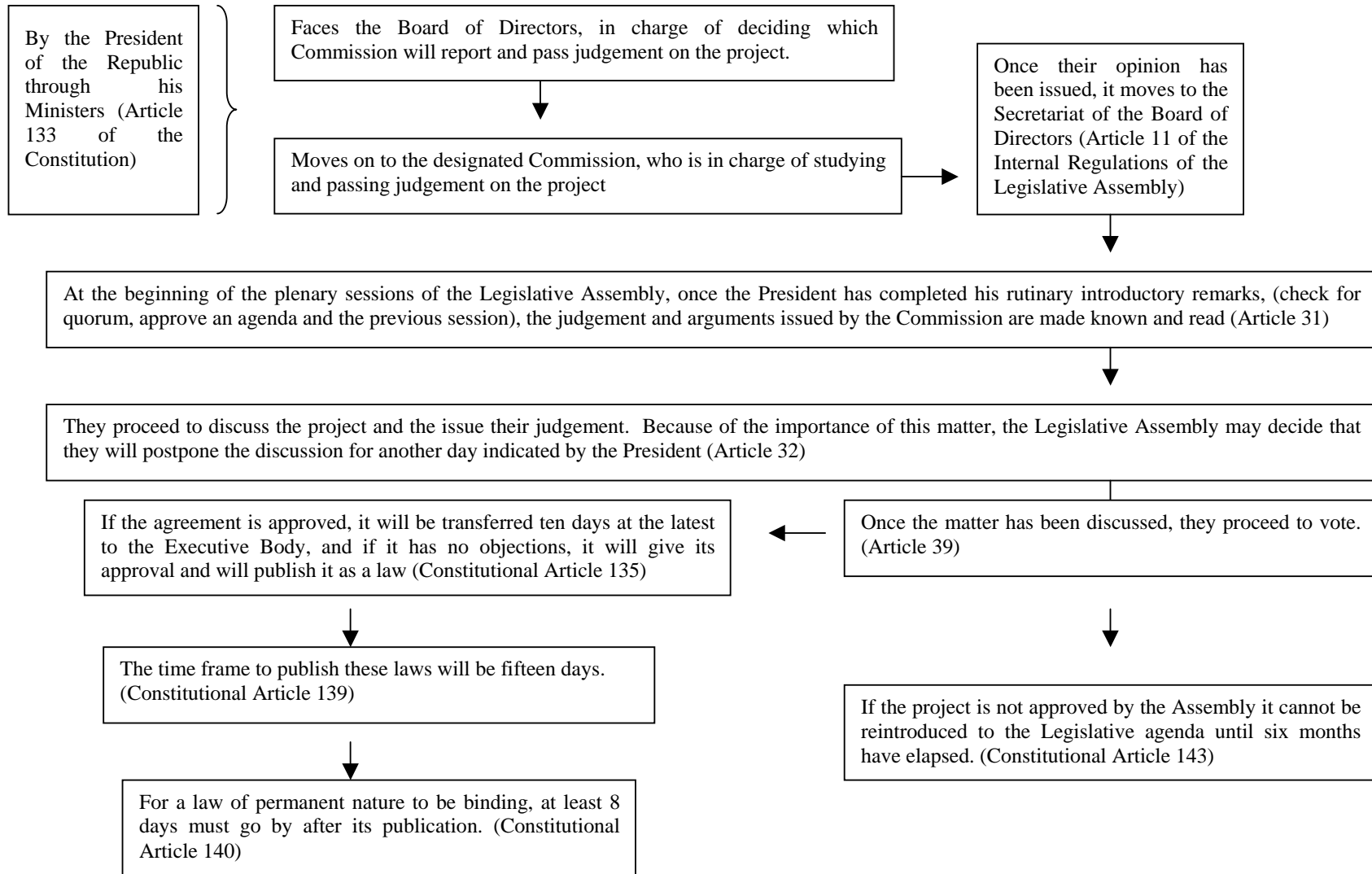
Fish and Crustaceans	79	-14 %	Medium
El Salvador			
Total Imports	2,076	2 %	
Articles of Apparel and Clothing	1,789	3 %	High
Coffee	48	40 %	Low-Medium
Sugar	41	49 %	Medium
Electrical Machinery and Equipment	23	-17 %	Medium
Articles of Paper	23	-30 %	Medium
Beverages	16	40 %	High
Guatemala			
Total Imports	3,160	7 %	
Articles of Apparel and Clothing	1,814	6 %	Medium-High
Bananas and Other Fruits	423	4 %	High
Coffee	225	25 %	Medium-High
Petroleum Oils	194	16 %	High
Sugar	101	57 %	Medium
Vegetables	61	22 %	High
Honduras			
Total Imports	3,454	2 %	
Articles of Apparel and Clothing	2,623	3 %	Medium-High
Bananas and Other Fruits	208	2 %	High
Fish and Crustaceans	130	-6 %	Medium-High
Electrical Machinery and Equipment	100	35 %	High
Tobacco	70	-6 %	Medium
Precious Metals	68	-8 %	Medium-High
Nicaragua			
Total Imports	801	14 %	
Articles of Apparel and Clothing	498	12 %	Medium-High
Fish and Crustaceans	72	-15 %	Medium
Coffee	42	28 %	Low-Medium
Electrical Machinery and Equipment	40	1000 %	High
Meat	39	10 %	High
Tobacco	21	-6 %	Low-Medium

Source: Own elaboration with data from the US International Trade Commission, and CLACDS estimations

Appendix B Diagrams of FTA ratification process for Costa Rica's and El Salvador's Congress

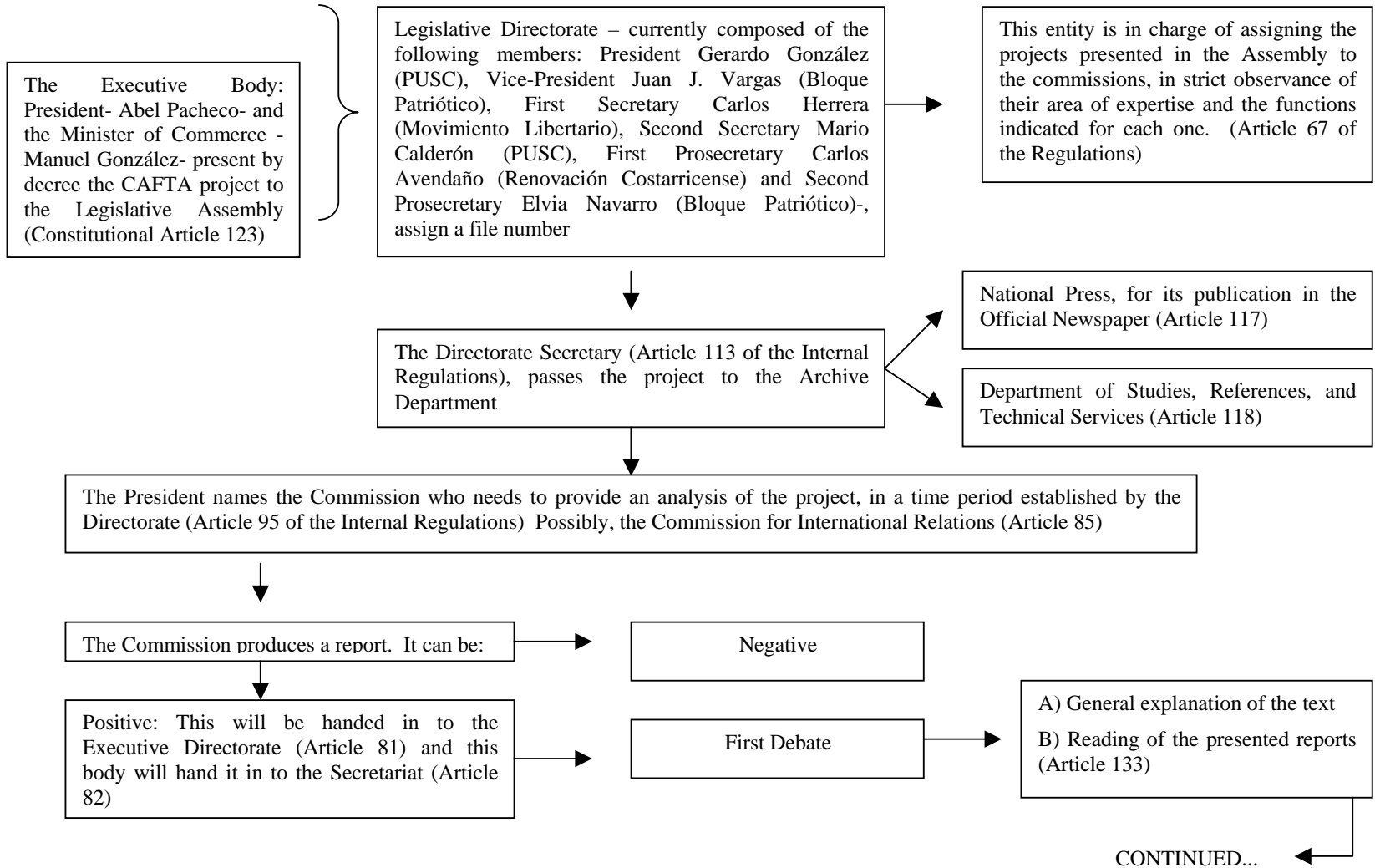
Costa Rica and El Salvador represent contrasting examples of the CAFTA approval process that each nation must undergo. In El Salvador's case, there was a sufficient amount of consensus in the Congress to approve the agreement without setbacks or delays, except the normal rules and regulations governing congressional proceedings and the Constitution. On the other hand, Costa Rica's current political landscape has created a cautious atmosphere regarding ratification. The Executive has conditioned its approval to the completion of a "fiscal reform project." Also, the Congress is divided to the point that no political fraction has enough votes to guarantee an approval without negotiation with other groups. Finally, there are also political groups that oppose the ratification of CAFTA in its "actual form," particularly the Acción Ciudadana Party.

CAFTA's approval process in El Salvador. Law ratification scheme, according to Article 133 of the Constitution



Source: Own elaboration with information from the Internal Regulations for the Legislative Assembly of El Salvador, (last updated April 2002).

CAFTA's Discussion Process in Costa Rica's Congress. Law ratification scheme



Source: Own elaboration based on Regulations for the Legislative Assembly of Costa Rica, and the Constitution of the Republic of Costa Rica.

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