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CAFTA CLEARS COMMITTEES, AWAITS SENATE AND HOUSE ACTION

The proposed United States-Caribbean-Dominican Republic Free Trade Agreement (CAFTA-DR for short) would cover Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and the United States. It was reported out of the Senate Finance Committee by a narrow 11 to 9 vote on June 14, and by the House Ways and Means Committee by a vote of 25 to 16 on June 15. It must now be considered by the full Senate and House.

CAFTA-DR is of clear benefit to the people of the United States. It is being opposed by the sugar lobby, and some in the labor and environmental movements. This opposition has slowed consideration of the agreement. The initial trade agreement with the five Central American nations was signed on May 28, 2004. Agreement was reached with the Dominican Republic on August 5, 2004. Thus, the pacts have been awaiting ratification by the Congress for roughly a year.

That CAFTA-DR is in some difficulty in the Congress is a sad commentary on the state of economic understanding and the policy making process in Washington. If Congress were to reject a trade agreement so favorable to the United States, it would cast a pall over any future trade negotiations. No one would credit any proposals made by the U.S. Trade Representative and the President, because it would be assumed that they would not clear Congress. Liberalization of global trade would be jeopardized.

Gains and losses from trade: using gains to ameliorate losses

The gains from trade have been motivating economic activity by ordinary people since human commerce began, and have been understood, documented, and measured by economists for at least two centuries. When it comes to removing tariffs and trade barriers that have protected certain industries, however, there are generally some losers among the many winners, and their vocal opposition is why trade agreements can founder.

Fortunately, the gains to the winners almost always outweigh the harm to the losers by a wide margin. It is therefore possible for the winners to compensate or assist the losers to some reasonable degree, or even to buy them off outright, and still leave significant net benefits to the population at large. This is the justification for trade adjustment assistance. The goal of adjustment assistance should not be to freeze resources in the protected area, but rather to compensate them for the trouble involved in finding and training for alternative employment.

The Senate Finance Committee has recommended that the legislation submitted to enact CAFTA-DR include extension of trade adjustment assistance to people in the service sector (in addition to factory workers already eligible). Services have become a much larger component of world trade in recent years, and the extension would make sense. There is also talk of a compromise with the sugar

interests to smooth passage of the trade pact. (See below.)

CAFTA-DR: Mostly gains for the U.S.

In the special case of CAFTA-DR, there are very few U.S. losers. The United States has already completed most of the economic adjustments that would be triggered by CAFTA-DR, because of previous trade arrangements with the CAFTA-DR partners. Under the Caribbean Basin Trade Partnership Act, the United States has already granted duty-free entry to some 80 percent of manufactured goods and 99 percent of agricultural products from the other CAFTA-DR countries. The remaining U.S. tariffs are minor. Consequently, U.S. businesses and workers affected by imports have already undergone most of the economic adjustments that would be associated with the tariff reductions contemplated under CAFTA-DR.

By contrast, the tariffs levied on U.S. products entering the CAFTA-DR nations are higher, ranging from an average of about 2 percent in Nicaragua to about 10 percent in the Dominican Republic. Consequently, removing the remaining barriers would be a clear benefit to U.S. exporting businesses and their workers. The National Association of Manufacturers estimates that the agreement will boost manufactured exports by $1 billion, and preserve an additional $4 billion in exports made possible under the Caribbean Basin Partnership. In a study of 12 states, the U.S. Chamber of Commerce estimates an increase in U.S. sales of all types to the region of $3.9 billion in the first year, and, for 11 states for which data are available, estimates an increase of $20 billion by the ninth year of the pact. The American Farm Bureau Federation estimates that CAFTA-DR could raise annual U.S. exports of grains, meat, fruits, and vegetables to the region by about $1.44 billion, to about twice current levels. The increase would be about twice the current agricultural trade deficit with the region. The agreement would open markets for the region's service sectors, which include such industries as construction, financial services, entertainment, transportation, telecommunications, information services, and professional services. The agreement would improve protection of intellectual property rights. Among the signatories, the United States has the most to gain in these sectors.

Balance of payments

As a share of income, the CAFTA-DR nations spend more on U.S. products than the United States spends on CAFTA-DR products. As trade expands, and the pact nations sell more to the United States and expand their incomes, they will also buy more from the United States. Given the relative heights of the remaining tariffs between the United States and the other signatories, it seems likely that U.S. manufacturing, services, and materials exports to those nations will grow by at least as much as their exports to the United States.

The Caribbean Basin Initiative will expire in 2008. That expiration casts a pall on the region, and discourages capital formation in those countries. Passage of CAFTA-DR would make permanent existing access to the U.S. market, extend access to other sectors, restore certainty and reduce risk. The non-U.S. CAFTA-DR countries would retain more of their own saving and attract more of capital from abroad than without the agreement. The enhanced capital inflow would increase these countries' abilities to make purchases abroad, including from the United States. The reduction of investment risk and the resulting strengthening of the non-U.S.CAFTA-DR economies would promote political and social stability, which would further improve economic performance in a virtuous circle.

Textiles

One industry that has opposed free trade agreements in the past is on board this time. The National Cotton Council and the National Council of Textile Organizations have endorsed CAFTA-DR. The pact contains "rules of origin" requiring the use of CAFTA-DR country yarns and textiles for duty free imports of apparel into the United States. In practice, that means using U.S. yarns and cloth. This feature of the agreement sustains the existing

diversion of about $10 billion a year of finishing operations from lower cost Asian producers to the CAFTA-DR countries that has already been created by the Caribbean Basin Trade Partnership Act.

The use of the U.S. textiles makes the CAFTA-DR products more expensive than imports from Asia before the tariff differential, but the reduction in the tariffs gives the CAFTA-DR sources an edge. Finishing garments using U.S. textiles in the low cost signatory nations makes the U.S. textile industry more competitive with Asian producers. The finishing jobs will not be lost in the United States; they are already gone. U.S. consumers and the other CAFTA-DR producers would have been better off without this restrictive rule of origin, but the opposition of the U.S. textile industry might have doomed the bill. In any event, the rule would buy more time for the U.S. industry to adapt to the erosion of protection it has experienced since the expiration of the global multi-fiber textile agreement last year.

Sugar

U.S. sugar cane and sugar beet growers, and sugar processors, are opposing CAFTA-DR. These same interests opposed the United States-Australia trade pact that was adopted last year until sugar was excluded from the agreement.

CAFTA-DR would increase the U.S. sugar import quotas for the participating nations by a mere 109,000 metric tons. That compares to a U.S. sugar output of 7.8 million metric tons per year. The increase in CAFTA-DR sugar sales will grow from about 1.2 percent of U.S. consumption in the first year of the agreement to about 1.7 percent over 15 years, according to the USTR. But U.S. consumption of sugar will grow by much more than the CAFTA-DR quota hike over the period. The quota increase represents less than a year's increase in sugar consumption. In fact, the Agriculture Department forecasts that foreign quotas will need to rise by about 600,000 tons to keep up with U.S. demand in 2005/2006. The CAFTA-DR quota increase would have a negligible impact on the U.S. sugar industry. The industry appears to be chiefly concerned that the pact will set a precedent for further quota increases in future trade agreements with the rest of the Americas or in the world trade negotiations.

Several senators from sugar producing states have indicated interest in a compromise, and the White House has signaled willingness to talk. A compromise cannot take the form of restricting the quota increases agreed to in the negotiations with the CAFTA-DR nations, which would required re-opening negotiations. Nor, for the sake of U.S. sugar consumers, should a compromise restrict other nations' quotas, or squeeze domestic marketing allotments to sustain high prices. Rather, it should involve enactment of temporary assistance to those exiting the industry, or of a lump sum payment to compensate those whose future earnings will be impacted if they stay in. However, given the minimal impact on the industry, it is not clear that much needs to be offered, or how much is deserved.

About 50,000 jobs are involved in growing and processing U.S. sugar cane and sugar beets. These have been protected for decades at considerable expense to (now) nearly three hundred million U.S. consumers. Sugar prices in the United States are two to three times the world price. The resulting increase in the price of U.S. foodstuffs is a regressive hit on the poor, who spend a larger portion of their incomes on food than do higher income families. This protection has also injured U.S. makers of candy and other sugar-containing foods, has forced some of that production abroad, and has cost more jobs in the U.S. food industry, which employs about 725,000 people, than it has preserved in the sugar growing regions.

In addition to the direct cost to U.S. sugar consumers, the quotas and tariffs have caused land to be taken out of the production of other crops that, except for the trade restrictions, would be of greater value than the sugar cane and sugar beets. The real, undistorted value of national agricultural output would be higher if we paid the value of the protection money to the sugar growers, but allowed

them to switch to other crops. Agricultural workers have not benefitted from the over-commitment of land to sugar production; they would have been employed in the production of the other crops anyway. The gains have accrued as economic "rents" to landowners and sugar processors.

It might also be noted that there are environmental advantages to growing sugar cane in areas where it is a native crop, places where it is less of a strain on scarce water resources than it is in southern Florida on the fringes of the Everglades.

Labor and environmental standards

The CAFTA-DR countries are signatories to most of the leading international labor standards agreements. U.S. labor organizations have been trying to force tighter labor standards and environmental regulation on foreign governments through trade pacts. This is not being done out of humanitarian concern for foreign workers or the environment, but as a protectionist measure. Foreign workers are attracted to the export jobs because they are better than other jobs available to them. If improving foreign social conditions were the objective, then supporting the trade agreement would be the best course.

Environmental concerns are also misplaced. Rich countries do the most to clean the air and water. As living standards rise in the non-U.S. CAFTA-DR signatories, the countries will be able to do more for the environment.

Conclusion

Passage of the U.S.-CAFTA-DR trade agreement would be of significant net economic benefit to all the parties involved, and would strengthen prospects for success in future global trade negotiations. Any economic costs to particular sectors in the United States have either already been absorbed, or can be ameliorated with trade adjustment assistance. CAFTA-DR would also improve the political and social climate in Central America and the Dominican Republic, and help to stabilize the region. The agreement should be adopted promptly.

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Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.