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# THE IMPACT OF CAFTA-DR

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# THE IMPACT OF CAFTA-DR

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KSC Research Series

**ABSTRACT:** This is a brief annotated bibliography of academic and policy materials examining the social, economic and political impacts of the Central American Free Trade Agreement - Dominican Republic (CAFTA-DR).

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## TABLE OF CONTENTS

|  |   |
|--|---|
| I. Policy and Think-tank Sources ..... | 1 |
| II Academic Sources.....               | 6 |
| Conclusion.....                        | 9 |
| References.....                        | 9 |

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# I. Policy and Think-tank Sources<sup>1</sup>

The literature pertaining to the impact of U.S. – Dominican Republic – Central American Free Trade Agreement (CAFTA-DR) can be roughly broken into **two types of sources**. The first is a policy perspective geared towards consumption by program implementers such as governments, non-profit donors and non-government agencies. This perspective may also include more technical pieces written by legal-scholars or attorneys practicing labor and trade law. The second and largest source is academia with studies done by scholars who are typically economists. There is some overlap within this dichotomy however.

I. Policy reports may be objective and empirical or they may have a political slant depending on the author and his/her institutional affiliation. In one objective report, the Congressional Research Services summarizes CAFTA-DR as a reciprocal trade agreement replacing U.S. unilateral preferential trade treatment to these countries under the Caribbean Basin Economic Recovery Act (CBERA), the Caribbean Basin Trade Partnership Act (CBTPA), and the Generalized System of Preferences (GSP).

It concludes that while the agreement is not expected to have a significant cumulative effect on the U.S. economy due to the relatively small size of the Central American economies and pre-existing preferential trade agreements, advocates of the CAFTA-DR cite its potential as a policy foundation for improved interregional trade and long-term social, economic, and political development in an area of strategic importance to the United States. Others experts are concerned that the agreement is deficient in key areas, specifically policies on trade adjustment, trade capacity building, labor regulations, intellectual property rights, and investment provisions.<sup>2</sup>

Another broad policy discussion of the impact of CAFTA is nicely summarized by Richard Feinberg in his article on the “new post-Washington Consensus on Latin America”. This consensus revolves around three issues: correcting any remaining market inefficiencies, improving the quality of democratic governance and reducing the social deficit.<sup>3</sup> In comparing Nicaragua’s pro-CAFTA agenda and Chile’s “Compete” program, he concludes that the ratification of the treaty in 2004 by the Nicaraguan government has been successful in harnessing trade benefits and economic growth. The Nicaraguan congress was able to take advantage of the international market opening by using national competitiveness measures to streamline smaller firms, private property and institutions to improve agricultural standards. CAFTA was also successful because of the parliamentary-approved infrastructural improvements including new roads, technology transfer to smaller firms, social equity through credits to farmers’ cooperatives and larger health budgets.<sup>4</sup>

Diego Sanchez sets constraints on the benefits of CAFTA and sees it more as a tool of American geopolitical strategy. He asserts that the treaty is problematic as an instrument of true development because it imposes non-priority reforms, eliminates useful instruments of economic policy, and requires higher adjustment costs for the smaller economies.<sup>5</sup> A more balanced vision of relations between the state and the market is needed in these countries to take into account

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<sup>1</sup> The authors would like to acknowledge Steven Morgan and Madeline Sopko for their participation and support of this document

<sup>2</sup> Hornbeck, J. F. 2008. CRC Report for Congress: The Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR).

<http://www.nationalaglawcenter.org/assets/crs/RL31870.pdf>

<sup>3</sup> Feinberg, Richard. 2008. Competitiveness and Democracy. *Latin American Politics and Society* 50(1): 164.

<sup>4</sup> Ibid.

<sup>5</sup> Sánchez Ancochea, Diego. 2006. Fortalezas y debilidades de la política comercial y de desarrollo de EEUU: un análisis del caso centroamericano.

<http://dialnet.unirioja.es/servlet/articulo?codigo=2057846&orden=75478&info=link>

the deficiencies of the aforementioned-Washington Consensus. Since Guatemala and the Dominican Republic are neglected by the program, Sanchez sees the attempt to mitigate these negative consequences through the Millennium Challenge Account (MCA) as flawed.<sup>6</sup>

Agosin views CAFTA as a long-term project for the region. It is a way to stimulate investment and facilitate the emergence of new sectors of comparative advantages. To make the most of the opportunities, governments must solve fiscal problems and monitor capital while harmonizing the integration of financial markets, customs unions and bilateral exchange rates.<sup>7</sup> If these reforms are not in place, CAFTA will affect tradable goods negatively and slow the structural transformation of whole economies. In concluding, the authors state that there will be losers from trade, like poor farmers who will not be able to bear the costs of liberalization. However, the international community can assist those who suffer as a result of free trade with technical cooperation and resources. The overall goal of CAFTA is to improve competitiveness by removing barriers to trade and increasing labor productivity.

Works comparing other free trade agreements (FTAs) to CAFTA are also a valuable analytical tool. Fiess looks at the relationship between the real business cycle and regional integration. He theorizes that business cycle synchronization (BCS) provides important information on the need of independent fiscal and monetary policy. If business cycles are similar and exogenous shocks are common, then coordinating macro policies can become desirable (i.e. use of a common currency).<sup>8</sup> On the other hand, if shocks are mainly country-specific then the ability to conduct independent monetary and fiscal policy is usually seen as important in helping an economy adjust to a new equilibrium.

Clark and Rees examine intra-industry specialization and trade in the U.S. textile and apparel industries from 1992-2004. They also provide a separate analysis of U.S. bilateral trade with China, Mexico, and CAFTA-DR members.<sup>9</sup> They find that adjustments by American firms became necessary as American textile trade with CA increased by 13%. Furthermore, they predict that greater specialization will be needed by all firms to compete with China, a source of increasing textile exports.

In another study of possible trade effects from CAFTA, Leister analyzes demand for the U.S. beef value cuts in Guatemala in the overall framework of the USMEF promotion program.<sup>10</sup> He looks at consumer responsiveness to branded beef promotion activities in Guatemala City over one year and wants to understand consumer sensitivity to changes in prices over the same period. While his example does not draw conclusions beyond this sector, it does indicate that increasing trade is benefiting one US industry since overall U.S. beef exports to Guatemala increased 52% in 2006 compared to 2005.<sup>11</sup> He warns, however, that it is unlikely that CAFTA-DR or the MEF promotion accounted for *all* of this expansion in exports.

Some articles mix policy and academic approaches. Morley examines the effects of changes in tariffs in agriculture, processed agricultural commodities and textiles that are contained in the CAFTA agreement, factors that likely impact domestic prices and producers in Central America. He summarizes that the effects of trade liberalization will be small due to already low tariffs under the previous Caribbean Basin Initiative and the gradual tariff reductions set for sensitive

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<sup>6</sup> Ibid p. 7

<sup>7</sup> Agosin, Manuel and Rodríguez, Ennio. Libre comercio en América Latina: ¿con quién y para qué. Las implicancias del CAFTA.

[http://www.iadb.org/intal/aplicaciones/uploads/publicaciones/e\\_INTALITD\\_DD\\_37\\_200](http://www.iadb.org/intal/aplicaciones/uploads/publicaciones/e_INTALITD_DD_37_200)

<sup>8</sup> , Norbert. 2005. Business cycle synchronization and regional integration: a case study for Central America. World Bank Paper No. 3584.

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=743906#PaperDownload](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=743906#PaperDownload)

<sup>9</sup> Clark, Don; Rees, Kathleen. 2007. "Intra-Industry Specialization in Textiles and Apparel" *Global Economy Journal* 6(4).

<sup>10</sup> Leister, Amanda; Capps, Oral Jr.; Rosson, C. Parr III. 2008. The Economic Effects of New Product Beef Promotion in Guatemala.

<http://ageconsearch.umn.edu/bitstream/6067/2/470637.pdf>

<sup>11</sup> Ibid p. 31.

agricultural products.<sup>12</sup> In the long run, Morley is adamant that domestic producers will see price decreases for important commodities. To remain competitive, farmers and producers must use the time granted by these staged tariff reductions to research and invest in activities that will lead to greater productivity in the future.

In a second analysis, Morley et al. utilize a comparable general equilibrium (CGE) model to analyze the effects of CAFTA on growth and poverty in El Salvador. He summarizes that while CAFTA will improve growth prospects and reduce poverty. The differences will be small unless the investment rate is impacted. Agriculture will grow at a faster rate, and the expansion of the maquila industry will create new opportunities for unskilled labor. For skilled labor, the benefits of CAFTA will be found in the form of rising wages. The key to this growth, however, is the attraction of foreign direct investment, without which growth will remain slow. He advises that growth can be increased in one of three ways.

First, already employed resources can be moved to sectors where they are more productive and where the results are positive but small. Second, the structure of demand can be changed in such a way as to increase the demand for previously unemployed unskilled labor. Finally, the supply of capital can be increased by increasing the rate of capital formation.<sup>13</sup>

Finally, Morley et al. utilize the same model on data from Honduras by focusing on tariff reductions, quotas, changes in the rules of origin for *maquila* and treatment of foreign investment.<sup>14</sup> They suggest that CAFTA has a positive effect on growth, employment and poverty but the effect is small. What really matters for Honduras is the assembly (*maquila*) industry in which the trade regime liberalized the rules of origin for imports into this industry, raising the growth rate of output by 1.4% and reducing poverty by 11% in 2020 relative to what it would otherwise have been. Increasing capital formation through an increase in foreign investment in response to CAFTA has an even larger impact on growth, employment and poverty. These simulations say something important about the growth process in a country like Honduras where it seems reasonable to assume that there is underemployed, unskilled labor willing and able to work more at a fixed real wage. In such an economy changing the structure of demand in favor of sectors that use a lot of unskilled labor will have a big impact on growth.

Jansen et al. investigate the effects of CAFTA on the apparel value chain in Central America by comparing the presence of the treaty along with Caribbean Basin Initiative/Caribbean Basin Trade Partnership Act. They use a variety of methodologies including field visits, personal interviews and computable general equilibrium (CGE) models and combine these with micro-simulations based on household surveys. In general, the results suggest that maquila provisions add between .01% to 1.4% per year to annual economic growth and poverty fell to almost zero in Costa Rica and 0.73% in Honduras per year relative in comparison to a scenario without the CAFTA impact.<sup>15</sup> Their model however does not take into account the quota system for textiles and clothing that expired in January 2005 or China's limits on exports to the US market. They recommend that to compete with Asia, CA economies begin full-package production rather than pure assembly and maintain socially responsible production conditions for higher quality apparel.

Policy reports can also take a legalistic and often qualitative perspective and this is reflected well in Garcia who applies a classic dependency theory view in his criticism of CAFTA. He specifically looks at the power relations within the international trade and political systems and

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<sup>12</sup> Morley, Samuel. 2006. "Trade liberalization under CAFTA: an analysis of the agreement with special reference to agriculture and smallholders in Central America". International Food Policy Research Institute <http://www.ifpri.org/divs/dsgd/dp/papers/dsgdp33.pdf>

<sup>13</sup> Morley, Samuel, Nakasone, Eduardo and Pineiro, Valeria. 2007. The impact of CAFTA on poverty, distribution, and growth in El Salvador. International Food Policy Research Institute. <http://www.ifpri.org/pubs/dp/IFPRIDP00743.pdf>

<sup>14</sup> Morley, Samuel, Nakasone, Eduardo and Pineiro, Valeria. 2008. The impact of CAFTA on employment, production, and poverty in Honduras. International Food Policy Research Institute. <http://www.ifpri.org/pubs/dp/IFPRIDP00748.pdf>

<sup>15</sup> Jansen, Hans G.P.; Morley, Samuel; Kessler, Gloria; Pieiro, Valeria; Sanchez, Marco; Torero, Maximo. 2007. The impact of the Central America Free Trade Agreement on the Central American textile maquila industry. International Food Policy Research Institute. <http://www.ifpri.org/pubs/dp/ifpridp00720.pdf>

how they might influence any results. For Garcia, free trade requires that global economic relations be structured through agreements reflecting the consent of those subject to them. He believes that the neo-liberal trading system of today imperfectly lives up to this obligation, adding that trade law today reveals a policy mix of free trade and either exploitation, coercion or predation depending on where a country stands in the economic system.<sup>16</sup> He is perhaps most skeptical about the “good” intentions of open trade.

Maldonado is also dubious about the benefits of CAFTA in his analysis of Guatemala. Taking from the work of George Soros and Joseph Stiglitz, he suggests the agricultural sector will be affected most with tariff decreases impacting corn revenues. Worker salaries will drop significantly, as a result, increasing income inequality due to the lowering of subsidies required by CAFTA.<sup>17</sup>

Another qualitative method is content analyses, a tool normally reserved for historians. Yet Otterdahl employs an unconventional approach in her senior thesis by taking twelve documents from policy sources in Nicaragua and United States. In doing so, she creates five measures on support for CAFTA including impacts on development, personal economy, national economy, democracy and corruption all in an effort to interpret opinions on free trade and predict the future development of Nicaragua.<sup>18</sup> In asking how CAFTA-DR affects democracy and drawing on limited data, she concludes that both the US and Nicaraguan governments believe free trade will benefit democracy while journalists and NGOs are less optimistic.<sup>19</sup> She also finds in her small sampling that government officials believe free trade will reduce corruption while journalists and NGOs do not.<sup>20</sup>

Porto presents a more empirical and objective overview of the main mechanisms through which globalization can affect poverty and household welfare in Argentina and Guatemala. The first case study explores the impacts of agricultural trade liberalization on world markets with an emphasis on the effects of labor income via real wages. The second case study examines the impacts of CAFTA on net producers and net consumers among the indigenous population. The studies show that the impacts of trade on developing countries are heterogeneous.<sup>21</sup> In Argentina, there are gains from liberalization of world agriculture and higher food prices while in Guatemala the indigenous population would benefit from lower food prices.

O'Donovan takes a more optimistic view of CAFTA benefits in his comparison of effective enforcement of domestic labor laws in Singapore, Chile and the positivist law countries of Central America. O'Donovan points out that a major problem is enforcement of rules since sizable informal economies pose a significant obstacle to realizing strong labor protections. By reducing standards that people come to expect in the workplace, and increasing the perceived costs of “formal” business, the informal economy undermines the internalization of cultural norms that help self-police labor standards.<sup>22</sup>

He points out that CAFTA also utilizes the same broad international labor commitments and its member parties agree to “strive to ensure” that such principles are “recognized and protected by

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<sup>16</sup> Garcia, Frank J. 2007. Is Free Trade "Free?" Is It Even "Trade?" Oppression and Consent in Hemispheric Trade Agreements.

<http://lsr.nellco.org/bc/bclsfp/papers/186>

<sup>17</sup> Maldonado, Enrique E. 2006. El CAFTA en la economía de Guatemala - Implicaciones para el sector agrícola.

<http://www.eumed.net/cursecon/ecolat/gt/eemm-cafta.htm>

<sup>18</sup> Otterdahl, Helena. 2007. How Will Free Trade Affect The Development of Nicaragua? : - An analysis of opinions surrounding a recently signed free trade agreement. Bachelor's Thesis., Växjö University, Sweden [http://www.diva-portal.org/diva/getDocument?urn\\_nbn\\_se\\_vxu\\_diva-1736-2\\_fulltext.pdf](http://www.diva-portal.org/diva/getDocument?urn_nbn_se_vxu_diva-1736-2_fulltext.pdf)

<sup>19</sup> Ibid P. 35

<sup>20</sup> Ibid p. 36

<sup>21</sup> Porto, Guido G. 2007. "Globalisation and Poverty in Latin America: Some Channels and Some Evidence". *World Economy*. 30(9):1430-1456

Available at SSRN: <http://ssrn.com/abstract=1007564>

<sup>22</sup> O'Donovan, Michael. 2005. Labor Provisions from NAFTA to CAFTA: Standards That Work, or a Work in Progress? NELLCO (New England Law Library Consortium) Legal Scholarship Repository. pp. 10 <http://lsr.nellco.org/bc/ljawps/papers/2>

its (domestic) law". Yet he warns that CAFTA is qualitatively different due to the lower level of labor protections in Central America while the new laws will supplant the existing GSP under which Central American states currently enjoy preferential access to U.S. markets. By threatening to withdraw GSP preferences, the U.S. has been able to significantly influence domestic policy in recipient countries. Replacing the unilateral system with the reciprocalism of CAFTA will eliminate that source of U.S. influence. He has mixed views on CAFTA's impact on the informal sectors. He concludes that CAFTA will increase investment protections and private property reforms and reduce the costs of entry to the formal market but it may also reduce protections that would otherwise be available in the informal economy.<sup>23</sup>

Aleo looks at labor changes in his take on comparative advantage and protections in free trade agreements. He makes suggestions to make labor protection practical and in doing so, focuses on domestic laws in Central American countries. CAFTA can be a tool to help Central American and Dominican workers obtain the rights to freedom of association, the rights to organize and bargain collectively, a minimum age for child labor, acceptable conditions of work with regard to minimum wages, hours, and safety and health, as well as prohibitions on forced labor. Countries should have effective enforcement of labor standards using an independent body to investigate and enforce violations and they should have a regulatory process that is efficient and binding.<sup>24</sup>

Garcia-Bolivar sees CAFTA as an opportunity for cooperation between judges, lawyers, professional associations, and donors in using and improving commercial arbitration and mediation. He views the increase in trade as a chance for businesses to raise money through the sale of stock. This increase will occur through harmonizing stock market/exchange laws and building an inter-regional private sector working group focusing on a long-range goal of establishing a regional stock market.<sup>25</sup> In addition, the region would strongly benefit from improved coordination of donor funding for Small Medium Enterprises (SMEs) via a specialized SME development bank with preferential rates.<sup>26</sup> SMEs could then grant benefits to participating businesses, including special tax treatment and small-business quotas for government contracts, reduce complications and delays with the registration process, and reduce risks of credit lenders as qualified small businesses.

Reyes compares the impact of CAFTA-driven privatization of ports and transportation in Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua to those in Chile, Mexico, and Panama. He summarizes that CAFTA-DR will help persuade Central American countries to liberalize their maritime transportation sector. Central America ports should accept the entry of new private operators that could compete with newly transformed public companies. There are four strategies to solve current port problems: commercialization, liberalization, privatization, and modern polices. Privatization is oriented towards selling public agencies to the private sector with the purpose of eliminating subsidies, improving efficiency, and making the user pay the real cost of the services, encouraging more investment.<sup>27</sup> He concludes that trade and the legal procedures that accompany it will become more transparent and less hindered by corruption.

Finally, one timely report by Weisbrot concludes that a U.S. economic downturn is likely to play a role in any trade deficit-adjustment process (i.e. reduction of American imports from Central America). Unless declines in these exports are offset by some other source of demand, the falloff could be sufficient to push countries that the United States has implemented "free trade" agreements in recent decades with into recessions of their own (including the Dominican Republic-Central America Free Trade Agreement, DR-CAFTA, which includes the United States

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<sup>23</sup> Ibid, p. 10.

<sup>24</sup> Aleo, Michael. 2006. Comparative Advantage and Labor Protections in Free Trade Agreements: Making Labor Protections in Trade Agreements Practical and Effective. pp 33-35  
<http://law.bepress.com/expresso/eps/958>

<sup>25</sup> Garcia-Bolivar, Omar E. 2005. Preparing for CAFTA-DR: The Need of Commercial Law Reform in Central America. pp 49 of PDF.  
<http://law.bepress.com/expresso/eps/868>

<sup>26</sup> Ibid, p. 51

<sup>27</sup> Reyes, Jose Antonio. 2007. The Missing Point in CAFTA.  
<http://www.iadb.org/res/publications/pubfiles/pubWP-610.pdf>

along with Guatemala, El Salvador, Costa Rica, Nicaragua, Honduras, and the Dominican Republic).<sup>28</sup> Clearly, economic openness entails some economic vulnerability for developing economies.

## II Academic Sources

Academic studies on the impact of CAFTA are numerous and tend to center on trade growth in various sectors. In one study of the CAFTA-DR economies, Yeboah et al employ panel data over fourteen years. They use a gravity model that assumes the volume of trade between any two partners is an increasing function of their national incomes and a decreasing function of the distance between them that increases transportation and other transaction costs.<sup>29</sup> They find that the impact of differences in resources endowment, relative factor income and real exchange rates is positive. The positive sign of the exchange rate variable supports the theory that an appreciation of the U.S. dollar (depreciation of CAFTA currency) has a positive effect on imports from CAFTA countries (and negative on US exports) to CAFTA countries. A 1% percent appreciation of the dollar, increases imports from CAFTA by 0.34%. A 1% increase in the resources endowment differences will increase trade flow volume by 1.5%.

This result is consistent with the fundamentals of trade theory. In other words, trade is more pronounced among countries with different resource endowments. The size of a CAFTA economy relative to that of the U.S. also positively affects trade flows with a 1% increase in the relative size of the economy will increase bilateral trade flows by 1.04%. The distance variable had the expected inverse relationship but was only significant with 90% confidence. For every 1% increase in distance between Washington DC and the capitols of any CAFTA country, there will be a corresponding decrease of trade flows between the two countries by about 1.3%.<sup>30</sup> They also find that the U.S. may not benefit as much as the Central American economies (relatively speaking) and gains from trade flows in Central America might vary from 13% in Nicaragua to 1% in Guatemala.

Francois et al. determine that the most welfare-improving mechanism in CAFTA is the increase in FDI and the capital stock of the region. If CAFTA can improve the investment climate in the region and this is complemented with economic policies that improve infrastructure and increase competitiveness, then the region can achieve a path of sustainable growth.<sup>31</sup> But without any complementary economic policies, CAFTA will be a balancing force to counteract the negative impact of the implementation of the Agreement for Textiles and Clothing (ATC) protocol. Due to the great of importance of Textiles and Apparel (T&A) commerce with the United States, the Central American economies without CAFTA will be hurt by the increased competition of Chinese textiles and apparel goods. The authors highlight the importance of complementary policies in the agricultural sector, policies that can mitigate or reverse any negative effects while the phase-out of any import protection is being implemented.<sup>32</sup>

Bocock focuses on exchange rate effects on bilateral agricultural trade in her analysis of CAFTA. She hypothesizes that exchange rate fluctuations create shifts in the excess supply and demand between countries in the international market. Using import and export values between the U.S. and selected countries, she finds that the larger American economy follows theoretical

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<sup>28</sup> Weisbrot, Mark, Schmitt, John and Sandoval, Luis. 2008. "The Economic Impact of a U.S. Slowdown on the Americas." Center for Economic and Policy Research.

<sup>29</sup> Yeboah, Osei-Agyeman, Shaik, Saleem and Allen, Albert; Ofori-Boadu, Victor. 2007. Trade Effects of the Central American Free Trade Agreement. Selected Paper Prepared for Presentation at the American Agricultural Economics Association Annual Meeting, Portland, Oregon, July 29-August 1. <http://ageconsearch.umn.edu/bitstream/9815/1/sp07ye01.pdf>

<sup>30</sup> Ibid p. 10

<sup>31</sup> Francois, Joseph F., Rivera, Luis and Rojas-Roma, Hugo. 2008. Economic perspectives for Central America after CAFTA. CPB Netherlands Bureau for Economic Policy Analysis. p 40. <http://www.cpb.nl/eng/pub/cpbreeksen/discussie/99/disc99.pdf>

<sup>32</sup> Ibid p. 42

expectations while the Central American economies are influenced by underlying socioeconomic factors affecting trade.<sup>33</sup>

On the other hand, Johansson looks specifically at El Salvador when examining agriculture, the assembly industry and the micro, small, and medium businesses in the informal sector. She predicts that Salvador will have comparative advantages in some products in the agriculture sector while its assembly industry will be able to compete if it can stand against the competition with China. She claims that micro, small, and medium businesses are more orientated to the local market and will not be affected. She concludes that the lack of support from the government is a critical problem since technological transfer may be slow and workers in the farm sector will continue to move to the cities for jobs in the assemblies or in the informal sector or continue to migrate to the U.S.<sup>34</sup>

Raminen takes a similar approach in a study of CAFTA effects on Nicaraguan agriculture, the assembly industry and the micro, small, and medium businesses in the informal sector.<sup>35</sup> His results suggest that Nicaragua will have comparative advantages in some products in the agriculture sector but most likely the agricultural sector as a whole will decline. He supports Johansson's findings on Salvador when he claims that the assembly industry will grow as a result of an increase in FDI but there may not be any accompanying important technology transfers. Institutions also play an important role in re-allocating resources from declining sectors to expanding ones and adapting policies to attract FDI. If the institutions fail to help in the re-allocation process, then all the freed labor will not be absorbed by the expanding sectors leaving them with no other options than to either migrate to the cities and join the informal sector or to emigrate. Expanding sectors will absorb the freed labor from the declining ones raising salaries and internal demand, driving the micro, small, and medium-sized businesses while also reducing the need for workers to migrate abroad.

Granados and Cornejo look at the future of trade in the Americas through the lens of the CAFTA-DR arguing that hemispheric convergence through the consolidation of existing trade agreements is the way of the future.<sup>36</sup> While CAFTA-DR was not engineered as a force for convergence but rather as an instrument of accommodation for differing national interests, it is important as it points the way with its successes and failures towards simpler, more effective future agreements. For example, CAFTA-DR tackles issues of national interest by allowing some flexibility in commitments and demonstrates that imposed convergence is neither politically feasible nor prudent. While the authors point out that the treaty is not an inevitable step towards regional market integration, they are careful to emphasize that it represents an important development in this process. CAFTA-DR has the potential to become a sub-region in Latin America along the lines of MERCOSUR and the proposed South American Community of Nations that together could either encourage hemispheric convergence or divide the region into competing and discrete spheres of trade.

Pipkin asserts that CAFTA led to changes in labor regulation law unmentioned in the text of the agreement but which would not have occurred without the presence of a free trade agreement on the table.<sup>37</sup> He refers to these changes as the "invisible ink" of a free trade

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<sup>33</sup> Bocoock, Jennifer Eileen. 2006. Exchange Rate Effects on Bilateral Agricultural Trade: Analysis on the DR-CAFTA. Master's Thesis., LSU.

<sup>34</sup> Johansson, AnnaMaria. 2005. Predictable effects the Central America Free Trade Agreement will have on El Salvador. Master's Thesis., Södertörn University College.  
[http://www.diva-portal.org/diva/getDocument?urn\\_nbn\\_se\\_sh\\_diva-365-1\\_fulltext.pdf](http://www.diva-portal.org/diva/getDocument?urn_nbn_se_sh_diva-365-1_fulltext.pdf)

<sup>35</sup> Raminen, Rikard. 2008. Free trade in developing countries : What are the predictable long run effects of an implementation of the CAFTA for the different sectors of the Nicaraguan economy? Master's Thesis., Södertörn University College, Sweden.  
[http://www.diva-portal.org/diva/getDocument?urn\\_nbn\\_se\\_sh\\_diva-1573-1\\_fulltext.pdf](http://www.diva-portal.org/diva/getDocument?urn_nbn_se_sh_diva-1573-1_fulltext.pdf)

<sup>36</sup> Granados, Jaime and Cornejo, Rafael. Convergence in the Americas: Some Lessons from the DR-CAFTA Process. *World Economy* 29(7):857-891.

<sup>37</sup> Pipkin, Seth. 2007. Written in invisible ink : a case study on the politics of free trade reform and labor regulation in Guatemala; Case study on the politics of free trade reform and labor regulation in Guatemala. Master's Thesis., Massachusetts Institute of Technology.  
<http://dspace.mit.edu/bitstream/1721.1/37666/1/124064353.pdf>

agreement that can only be understood in the context the domestic political and institutional history. Pipkin supports his claims through a case study comparison of three Guatemalan examples of such “invisible ink”: two cases of unionization in the maquila industry, and a third of reform in the Guatemalan Ministry of Labor. Pipkin concludes there is more room for government to exercise regulation with foreign firms than previously thought and closer alliances between civil society groups and government should be developed. CAFTA is also a means for Ministries of Labor to expand their roles and form partnerships with private sector firms.

Hauck examines how CAFTA will affect trade liberalization in finance sector in El Salvador, Guatemala and Honduras. He finds a link between liberalization of trade in services and the specific situation and interests of developing countries. The greatest difficulty will be overcoming qualified labor shortages and infrastructural shortcomings especially in telecommunications.<sup>38</sup> He emphasizes the impact of foreign firms in Central America more than the impact of potential export of goods from there and believes new technology transfer will occur creating more market efficiency and innovation. Finally, Hauck also expects CAFTA will strengthen the regulatory and supervisory institutions of the financial system but the insurance sector will feel the most change with entry of US firms in Honduras in Guatemala. Financial liberalization and subsequent regulatory enforcement will be key especially if the many small and medium sized firms are to do well in the free trade area.

Taylor et al ask if agricultural liberalization resulting from CAFTA reduces rural welfare.<sup>39</sup> They employ a disaggregated rural economy-wide modeling approach in testing tariff reforms in El Salvador, Guatemala, Honduras, and Nicaragua and look at subgroups in each country: subsistence grain producers, small, medium and large commercial producers and landless rural households. They also use the economy-wide model to estimate the transfers that would be required to maintain all rural household groups at their pre-CAFTA welfare levels. They conclude that trade reforms opening new markets for agricultural exports would also create positive rural economic while negative income effects of own-tariff removal are mitigated to the extent those households are able to channel resources into other crop and non-crop activities in response to price shocks.<sup>40</sup> They add that impediments to households’ capacity to adjust would tend to amplify negative welfare effects of trade reforms, and partly because of this, incomes would be negatively affected more for some rural household groups than for others.

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<sup>38</sup> Hauck, Benjamin Christoph. 2006. Trade Integration and the Rise of the Service Sector in Latin America : the Case of Honduras. University of Konstanz.  
[http://www.ub.uni-konstanz.de/kops/volltexte/2006/1880/pdf/Trade\\_Integration\\_and\\_the\\_Rise\\_of\\_the\\_Service\\_Sector\\_in\\_Latin\\_America\\_The\\_Case\\_of\\_Honduras.pdf](http://www.ub.uni-konstanz.de/kops/volltexte/2006/1880/pdf/Trade_Integration_and_the_Rise_of_the_Service_Sector_in_Latin_America_The_Case_of_Honduras.pdf)

<sup>39</sup> Taylor, J. Edward ; Naude, Antonio; Jesurun-Clements, Nancy. 2007. Does Agricultural Liberalization Reduce Rural Welfare in Less Developed Countries? The Case of CAFTA. Department of Agricultural & Resource Economics, UCD, University of California, Davis.

<sup>40</sup> Ibid p 25.

## Conclusion

Even with only gradual implementation of free trade, CAFTA-DR has made significant economic and political impacts throughout Central America because of the differences in scale between the U.S. and Central American economies. Experts in government, academia, the private sector and the trade sector all appear to agree that some benefits exist for all economies involved but those benefits are not consistent nor are they certain for *all* economic participants. Agriculture workers will not have the same experiences as large export companies and economies that are more diversified and multi-sectoral will be impacted differently than those less so.

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