IMPACT OF THE DR-CAFTA AGREEMENT ON BARBADOS AND CARICOM: PRELIMINARY INDICATIONS

by

Stacia Howard
Research Department
Central Bank of Barbados
P.O. Box 1016, Bridgetown, Barbados
Email: sphoward@centralbank.org.bb
Tel.: 1 (246) 436-6870
Fax: 1 (246) 427-1431

Presented at the 27th Annual Review Seminar
Research Department
Central Bank of Barbados
July 25-28, 2006

IMPACT OF THE DR-CAFTA AGREEMENT ON BARBADOS AND CARICOM: PRELIMINARY INDICATIONS

by

Stacia Howard
Research Department, Central Bank of Barbados

1. Introduction

Background

On May 28, 2004, the United States, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua signed the US-Central America Free Trade Agreement (CAFTA). Subsequently, the Dominican Republic was added to the agreement following separate negotiations and the new accord was titled the Dominican Republic-Central America-United States Free Trade Agreement, or DR-CAFTA.

The agreement is noteworthy, not only because of its content and coverage but its reciprocal nature as well, which distinguishes it from previous unilateral preferential trade arrangements between the US, Latin America and the Caribbean. The agreement defines detailed rules that govern market access for goods, services trade, government procurement, intellectual property, investment, labour and the environment. Consequently, DR-CAFTA is a pivotal development in the advancement of economic integration in the western hemisphere, coupled with the North American Free Trade Agreement (NAFTA); it constitutes a major stepping-stone towards the formation of the Free Trade Area of the Americas (FTAA).

Once ratified by all the participating countries[1], DR-CAFTA will allow more than 80% of U.S. consumer and industrial exports and over half of U.S. farm exports to Central America to be duty-free. For the DR-CAFTA countries, 100% of non-textile and non-agricultural goods would enter the United States duty free. Many goods would 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

[1] The countries that have already approved the agreement are the US, El Salvador, Guatemala and Honduras while Nicaragua, Costa Rica and the Dominican Republic are yet to vote on it.

effect. Duty-free treatment for sensitive products would face the longest delay, and in some cases, tariff reductions would not begin until 7 or 12 years into the agreement.

The agreement seemingly offers participating countries, especially those heavily dependent on the US market for exports, such as the Dominican Republic, a major advantage over non-participating countries. But, with the vast majority of the goods produced in participating countries already entering the United States duty free under the US-Caribbean Trade Preference Act (CBFTA), the successor agreement to the Caribbean Basin Economic Recovery Act (CBERA), of which CARICOM member states are beneficiaries, its implementation would not require substantial reductions in U.S. import duties.

Nevertheless, there are expected to be some gains, particularly for Dominican Republic. According to a recent World Bank study (2005a), DR-CAFTA could potentially raise U.S. demand for Dominican Republic exports by 10 to 20 percent. At the same time, the opening up of the Dominican Republic economy to U.S. imports should spark increased import demand, potentially altering the structure of production, particularly for firms previously producing for the domestic market. This study estimates the resulting long-run trade creation (increase in U.S. imports into the Dominican Republic displacing Dominican Republic products) at US$368 million. The increase in imports from the U.S. at the expense of lower priced imports from non-participating countries is projected at US$101 million (trade diversion effects). This study (World Bank 2005a) also estimates the trade creation in DR-CAFTA countries to be large, ranging from US$1.2 to US$2.5 billion.

Clearly, the benefit to the US will be significant given that the region covered by DR-CAFTA is the second largest Latin American export market for U.S. producers after Mexico, buying US$15 billion worth of goods per year. On the other hand, the net trade effect for DR-CAFTA participating countries (excluding the U.S.) will be heavily dependent on the extent to which their exporters can adjust to meet the preferential access criteria (otherwise they will continue to pay the most favoured nation (MFN[2]) rate).

Broadly, DR-CAFTA encompasses the following components:

- Services: all public services are to be open to private investment.
- Investment: to grant ironclad guarantees to foreign investment.
- Government procurement: All government purchases must be open to transnational bids.
- Market access: to reduce and eventually eliminate tariffs and other measures that protect domestic products.
- Agriculture: duty-free import and elimination of subsidies on agricultural products. Agricultural safeguards are included. US agricultural subsidies are not part of the agreement and will remain in effect while being dealt with at the WTO level.
- Intellectual property rights: privatization of and monopoly over technological know-how.
- Antidumping rules, subsidies and countervailing rights: governments commit to phase out protectionist barriers in all sectors.
- Competition policy: the dismantling of national monopolies.
- Dispute resolution: the right of transnationals to sue countries.
- Environmental protection: the enforcement of environmental laws and improvement of the environment.
- Labor standards: the enforcment of the International Labour Organization's core labor standards.
- Transparency: the reduction of government corruption.

Some Considerations for CARICOM

The important question which this discussion raises is what will DR-CAFTA mean for non-participating countries/regions, like CARICOM? The World Bank (2005a) study points to significant trade creation, which begs the question at which countries' expense will this trade

[2] MFN principle obligates WTO member countries to treat the imports of all other WTO member countries no worse than they treat the imports of their "most favored" trading partner. In other words WTO member countries must treat imports coming from all other WTO member countries equally, that is, by imposing equal tariffs on them, etc.

creation occur? The World Bank study (2005a) estimates that whereas the trade creation in DR-CAFTA counries is expected to be large (ranging from US$1.2 to US$2.5 billion), the impact on non-member countries would be diffused, with China, Mexico and Canada being the main losers. In this study, the loss is represented as a proportion of a country's total exports to the U.S. and the figures were negligible for many of the major exporters. Smaller exporters, like those in the CARICOM region, for which the proportion of exports to the U.S. relative to total exports may be significant are not considered in this study. Admittedly, the analysis also showed that when the trade impact is disaggregated by product much of the trade creation (trade diversion for non-participating countries) is in the apparel sector, which is not a major export category for CARICOM as will be seen later.

Clearly, a closer examination of US-CARICOM trade pattern is merited to better understand how the DR-CAFTA could impact CARICOM and Barbados. Existing trade rules determine market access levels and influence CARICOM and DR-CAFTA member countries (as beneficiaries) trade with the U.S. The DR-CAFTA agreement changes the rules for DR-CAFTA countries perhaps to the disadvantage of CARICOM member countries. Consequently, changes in market access arising from this agreement need to be examined as well as CARICOM and DR-CAFTA member countries' exports. The latter allows one to identify the extent to which these two goups of countries compete and the likely losses arising from an enhanced market access for DR-CAFTA member countries relative to CARICOM.

2. US-CARICOM trade pattern

Clearly, the impact on CARICOM of this agreement is contingent on the extent to which it improves Central American countries and Dominican Republic market access to the US relative to CARICOM. Even then, if exporters are unable to meet the preferential access criteria they must pay the MFN tariff. One possible approach to determining the possible loss would be to identify the magnitude of CARICOM trade to the US. This can be seen as an indicator of the upper limit of the likely loss arising from improved market access by Central American countries and the Dominican Republic. A more precise indication where the competition may intensify for the CARICOM region can be obtained from a comparison of the commodities exported to the US by these two groups of countries (CARICOM and CAFTA).

Table 1 shows the exports of CARICOM and CAFTA countries to the United States as a percentage of each country's or region's total export. According to this table, US-CARICOM trade is fairly significant, accounting for over 40 percent of CARICOM's total exports, and similarly for CAFTA countries. However, for the Dominican Republic the figure is considerably higher at over 80 percent. Unlike the other countries covered, the U.S. market figures less prominently in Barbados' trade, accounting for a mere 18%. These figures can be seen as indicative of the upper bound of the likely loss.

However, the possibility of realising this loss depends on the similarity of commodities traded by these two groups and the extent to which countries participating in the agreement have improved access over non-participating countries in the export of these similar products. Consequently, a commodity level analysis is necessary. At the commodity level, or more precisely the broad commodity groupings[3], mineral fuels, lubricants and related materials exported to the U.S. represents approximately 49% of CARICOM's total exports of this product and 60% of CAFTA but is insignificant for Barbados and the Dominican Republic. On the other hand, machinery and transport equipment exports to the US are an equally significant proportion of CARICOM, Barbados, CAFTA and Dominican Republic's total exports of this product category as well as miscellaneous manufacturing articles, although less so for Barbados.

An interesting aspect of this data is the export diversity of CAFTA-DR-US trade relative to CARICOM and Barbados. Exports to the US figure heavily in most of the product groupings for CAFTA-DR countries but less so for Barbados and CARICOM. Evident also from this table is the fact that the US is the one of the main trading partners of the CAFTA-DR group, unlike CARICOM. Although 44.3 percent of its exports are to the US, it is principally fuel exports from Trinidad and Tobago. Abstracting away this category, chemicals and machinery and equipment are the only product group for which exports to the US account for over 50 % of the country's total exports.

[3] The Standard International Trade Classification (SITC) is used

Table 1: Exports to the United States as a Percentage of Total Exports 2002

SITC	CARICOM	Barbados	CAFTA	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Dominican Republic[1]
ALL SECTIONS	44.3	18.0	38.8	47.5	20.0	30.2	46.3	26.1	83.3[2]
Food And Live Animals Chiefly For Food	21.9	3.2	41.6	45.5	26.2	40.2	51.7	30.7	78.8
Beverages And Tobacco	13.1	39.2	18.6	1.2	16.4	8.5	39.8	22.9	72.0
Crude Materials, Inedible, Except Fuels	18.0	8.9	33.4	38.5	34.1	32.4	40.1	5.1	48.3
Mineral Fuels, Lubricants And Related Materials	49.1	0.0	60.7	38.5	3.8	96.9	27.0	0.0	6.2
Animal And Vegetable Oils, Fats And Waxes	0.1	0.0	3.0	0.0	0.1	0.4	3.6	77.2	76.7
Chemicals And Related Products, Not Elsewhere Specified	62.1	1.7	3.0	3.6	2.7	2.3	3.2	7.9	24.7
Manufactured Goods Classified Chiefly By Material	27.2	6.0	18.4	21.9	21.7	6.2	25.5	18.5	24.2
Machinery And Transport Equipment	66.2	75.6	47.3	51.3	17.8	14.3	32.5	9.9	93.2
Miscellaneous Manufactured Articles	28.6	16.1	61.4	74.7	27.5	9.4	70.0	35.4	88.7
Commodities And Transactions	19.8	55.9	76.2	98.1	26.7	0.0	100.0	43.8	1.0

[1]Data for the Dominican Republic is for 1997
[2]Taken from IMF Direction of Trade Statistics Yearbook 2004
Sources: Barbados Statistical Service Annual Overseas Trade
IMF Direction of Trade Statistics Yearbook 2004
CARICOM Statistics Website
UN ECLAC Base de Datos de Comercio Exterior

Table 2 shows the leading exports of the countries and groups concerned. For CARICOM it is fuel, lubricants and related materials and manufacturing goods that account for over 80% of total export to the US. For CAFTA, the main commodities differ, with food and live animals, machinery and transport equipment and miscellaneous manufacturing accounting for the bulk of the goods exported. Barbados' export pattern (based on the leading exports) differed also from CARICOM but overlaps with CAFTA in the area of machinery and transport equipment.

Table 2: Exports to the United States by Commodity as a Percentage of Total Exports to the United States, 2002

	CARICOM	Barbados	CAFTA	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Dominican Republic[1]
ALL SECTIONS	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food And Live Animals Chiefly For Food	5.5	5.3	41.2	28.9	39.4	64.6	60.8	70.5	51.8
Beverages And Tobacco	0.8	26.6	0.7	0.0	1.8	0.7	2.5	3.5	13.3
Crude Materials, Inedible, Except Fuels	0.1	0.4	4.0	3.0	2.3	5.5	8.8	1.6	1.2
Mineral Fuels, Lubricants And Related Materials	59.8	0.0	4.4	0.8	1.0	22.2	0.0	0.0	0.0
Animal And Vegetable Oils, Fats And Waxes	0.0	0.0	0.1	0.0	0.0	0.0	0.3	1.4	0.1
Chemicals And Related Products, Not Elsewhere Specified	22.7	1.3	0.7	0.5	2.0	1.1	0.4	0.8	1.4
Manufactured Goods Classified Chiefly By Material	7.0	5.9	5.2	3.6	28.6	2.3	4.7	6.4	9.4
Machinery And Transport Equipment	2.6	45.0	19.5	30.8	4.1	1.7	1.9	1.7	5.5
Miscellaneous Manufactured Articles	1.4	7.2	22.6	31.9	20.8	1.9	11.8	5.5	10.6
Commodities And Transactions	0.1	8.3	1.6	0.3	0.1	0.0	8.8	8.7	6.6

[1]Data for the Dominican Republic is for 1997

Sources: Barbados Statistical Service Annual Overseas Trade
CARICOM Statistics Website
UN ECLAC Base de Datos de Comercio Exterior

This preliminary information points to some overlapping at the broad category levels, especially for Barbados and CAFTA. A more disaggregated product listing is needed to determine where the competition will arise. Although not covering all commodities, the United States International Trade Commission 16th report 2001-2002 provides more detailed product information on the leading U.S. imports from the countries being examined, but only for those products entering under CBERA. It showed some product overlapping for selected Caribbean countries, namely Jamaica and Guyana, with CAFTA countries and DR, in the area of female undergarments.

3. Market access changes

Identifying changes in market access requires an examination of the two agreements. According to World Bank (2005b) DR-CAFTA consolidates access terms gained by Central American nations through ongoing CBI preferences, eliminates remaining tariffs on a few sensitive goods in the U.S, and adds more flexibility to the rules of origin, especially for the export of apparel.

Some goods that will now enjoy zero tariff treatment under CAFTA include canned tuna for Nicaragua and products that contain sugar up to 65 percent, ethnic cheeses, fresh vegetables, snacks, fresh fruits and melon for El Salvador. Nicaragua also obtained a peanut and peanut butter quota.

Some agricultural goods were exempted from the eventual zero-duty status: sugar for entry into the U.S., white maize for entry into four of the Central America countries (El Salvador, Nicaragua, Honduras, and Guatemala) and potatoes and onions for Costa Rica. While the bulk of the tariffs will remain upon implementation, some will be phased out gradually and will vary by country.

For manufacturing the commitment is to include all manufactured goods, which represents an improvement over the CBI benefits. Tariffs will be eliminated for a few products explicitly excluded from the CBI preferences such as canned tuna, shoes, jewelry and hooks. The US has placed 19 Central American products on a ten-year gradual phase-out of tariffs. In effect, therefore, DR-CAFTA consolidates and expands the access that Central American exporters enjoy under CBI preferences for manufacturing, locking-in current trade policies and broadening them to apply to some sensitive items, after transition periods.

DR-CAFTA provisions on textile products effectively relax some of the current non-tariff barriers implicit in the rules of origin requirements that apparel and textile exports from Central America face under CBI.

Participating countries will benefit the most from the flexible set of market access conditions that any country enjoys in the US for this sector (World Bank, 2005b). In the short run the retroactive nature of the agreement and the flexible rules of origin should allow firms based in Central American countries to gain an edge in a more competitive environment in the U.S. market as a result of the end of global quotas in 2005. This could mean an increase in FDI flows to the Central American region, as was the case for Mexico following NAFTA.

These new features intended to facilitate goods to qualify for duty-free treatment are: unlimited use of regional inputs, flexible short supply lists, accumulation of origin with regional partners, exceptions for specific types of apparel, and temporary quotas for goods that do not need to meet strict rules of origin for Costa Rica and Nicaragua.

- The regional inputs contrast with the CBI provision for duty free and quota free treatment for goods made in Central America with U.S. inputs, and duty free entry for some goods that used regional inputs under quantitative restrictions. The treaty allowed for the accumulation of origin from Mexico as well as Central American parties to the agreement. This means that inputs would count as domestic inputs for minimum content requirements.
- The list of inputs sources from third parties without losing the zero duty status was expanded. The use of fabric for selected products, such as bras, boxer shorts, pajamas and sleepwear, and textile luggage, from third countries will be accepted provided “substantial” transformation takes place in a Central American country.
- The “de minimis” rule was changed so that the share of third party content that may be allowed in garments was increased from the level currently applied under CBI from 7% to 10%.

These developments would clearly affect CARICOM countries exporting these commodities to the US under the CBI. Namely, Jamaica and Guyana, for which undergarments are cited as one of their leading exports under the CBI. Of course, this is contingent on exporters being able to meet these requirements.

A large number of manufacturing products are subject to special rules of origin. It is more difficult to evaluate the impact of many sector-specific rules of origin. The World Bank study (2005b) argued that in some cases, these provisions are likely continue to pose significant barriers of entry to the U.S. market. This is key and is substantiated by the relatively low levels of CBI-benefiting exports.

It is important to note that the use of a phasing out period for sensitive goods means that CARICOM and other non-participating countries will not have to face differing market access rules/tariff levels to participating countries until after a given time period (5-10 years). Hopefully the FTAA would have been negotiated by this time.

4. Conclusion

Ideally, a disaggregated product listing for all exports to the United States by CARICOM member states, CAFTA countries and Dominican Republic and relevant price elasticities would be preferred to properly assess the likely impact of this new agreement. Following this a check for changes to market access arising from this agreement in the relevant overlapping product categories should be done.

Notwithstanding the usefulness of such an exercise[4], it is noteworthy that only 20.4% of CARICOM exports to the US entered under the CBI/CBPTA programme compared to 36.7 % for CAFTA-DR and a mere 5.1% for Barbados. Furthermore the percentage of American imports from CBI beneficiary countries has remained around 2% ((See Office of the United States Trade Representative (2003). This would suggest that market access is not sufficient, although necessary. Indeed, quite apart form the special rules of origin criteria, studies[5] have shown that non-tariff measures restrain export growth even in the absence of tariffs. These included: administrative bottlenecks, prerequisites relating to labour market conditions, quality standards and health safety requirements. While some of these were removed or reduced with the CBI amendment in 1990 and the CBTPA in 2000, it is possible that the hoops that producers and exporters had to jump through to access the American market served as a disincentive, as

[4] The plan is to obtain this information to undertake this exercise.
[5] See World Bank 2005a , b as well as Monge, Loria and Gonzalez-Vega (2003).

evidenced by the fact that only roughly half have qualified for preferential treatment under the CBI[6]. Monge, Loria and Gonzalez-Vega (2003) found that non-tariff barriers and a lack of information and know-how on overcoming these hurdles were among the major obstacles to new exports by Central American exporters to the US. It was in recognition of this that the DR-CAFTA was formulated with provisions for technical assistance to DR-CAFTA countries in overcoming sanitary hurdles for non-traditional agricultural exports into the US market. This is another added advantage of the agreement, which is likely to give these countries a competitive edge over CARICOM member states.

Indeed, the benefits of DR-CAFTA are evident when it is evaluated beyond the narrow focus on trade. One likely CAFTA-DR benefit over the CBTPA would be permanence of this agreement, which may influence investors to capitalize more fully on market access without concern about adverse policy changes. It is likely that this will lead to an increase in FDI flows to DR-CAFTA region as was the case for Mexico following the NAFTA. Clearly, CARICOM needs to forge ahead with its own integration efforts in order to better cope and further advance its integration in the wider western hemispheric integration process. In an environment where the US is quickly signing FTAs with countries in this hemisphere it would be in CARICOM's best interest to sign one with them and the US[7].

A failure to do so could see the region being placed at a competitive disadvantage in this hemisphere. Granted, CARICOM is of less strategic value to the US and may find itself last on the list for signing a FTA with the US. Advancing FTAA may be the only way forward for this region.

[6] Granted, the continual liberalisation of the U.S. tariffs under the Uruguay Round commitments, which permits these countries' exports to enter the American market as "MFN free" goods, may also explain why duty-free imports under CBERA have declined.

[7] The Caribbean Community (CARICOM) has already signed two bilateral free trade agreements with two members of the DR-CAFTA, the Dominican Republic (on Dec 1, 2001) and Costa Rica (on March 10, 2004). These agreements allow duty-free access to the Costa Rican and DR markets, while Costa-Rica and the DR are allowed duty-free access to the CARICOM MDCs-Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.

References

Ewart, Esq. A., (2003), *CARICOM Participation in Caribbean Basin Initiative: Lessons for FTAA.*

Monge, R., M. Loria and C. Gonzalez-Vega (2003), "Retos y Oportunidades para los sectores agropecuario y Agroindustrial de Centroamerica ante un tratado de libre Comercio con Estados Unidos", Report prepared for the World Bank DR-CAFTA studies programme. World Bank, Washington D.C.

Office of the United States Trade Representative (2003), *Fifth Report to Congress on the Operation of the Caribbean Basin Economic Recovery Act.*

Office of the United States Trade Representative (2001), *Fourth Report to Congress on the Operation of the Caribbean Basin Economic Recovery Act.*

United States International Trade Commission (2003), *The Impact of the Caribbean Basin Economic Recovery Act, Sixteenth Report 2001-2002.*

United States International Trade Commission (2001), *The Impact of the Caribbean Basin Economic Recovery Act, Fifteenth Report 1999-2000.*

United States International Trade Commission (1999), *The Impact of the Caribbean Basin Economic Recovery Act, Fourteenth Report, 1998 and Andean Trade Preference Act, Sixth Report 1998.*

United States International Trade Commission (1998), *The Impact of the Caribbean Basin Economic Recovery Act, Thirteenth Report, 1997 and Andean Trade Preference Act, Fifth Report 1997.*

United States International Trade Commission (1996), *Caribbean Basin Economic Recovery Act: Impact on U.S. Industries and Consumers, Eleventh Report 1995.*

U.S. Department of Labour Bureau of International Labour Affairs (1997), *Trade and Employment Effects of the Caribbean Basin Economic Recovery Act, Thirteenth Annual Report to Congress.*

Watson, H. A. (1987), "*The Changing International Situation and United States Interests: The Caribbean Basin Initiative and Caribbean Reality In: The Caribbean Basin Initiative: Genuine or Deceptive*", edited by G. O. Phillips and T. O. Shaw.

World Bank. (2005a), "Dominican Republic Review of Trade and Labour Competitiveness", Report no. 30542-DO, World Bank, Washington, D.C.

World Bank. (2005b), *DR-CAFTA: Challenges and Opportunities for Central America*, World Bank, Washington, D.C.